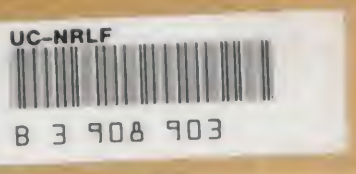

ARGUMENT

BEFORE

U. S. SENATE COMMITTEE ON BANKING AND CURRENCY IN SUPPORT OF SENATE BILL No. 3895 TO REGULATE THE USE OF THE MAILS, TELEGRAPH AND TELEPHONE BY STOCK EXCHANGES

March 16th, 1914.

By
Samuel Untermyer
of New York

MR. CHAIRMAN AND GENTLEMEN OF THE COMMITTEE:

The learned Counsel for the New York Stock Exchange has argued before you and has presented an elaborate brief against the constitutionality of this Bill. A similar argument was presented by him to the Pujo Committee.

If in the light of recent adjudications, the legal propositions for which he has assumed responsibility had been advanced by one less experienced and distinguished one would be disposed to characterize them as trivial but I feel that any proposition advanced by him is entitled to serious and respectful consideration. They are fully discussed and I think conclusively answered by the argument and citations that will be found at pp. 119-124 of the Report of the Pujo Committee and by a supplemental memorandum which is herewith submitted. I take issue with the assertion that the proposed Bill contains provisions that are intended by indirection to regulate the internal affairs of the Exchange and of the corporations whose shares are listed. There is not a requirement of this Bill that is not necessary to and does not bear directly upon safeguarding the mails against being used as an agency for the distribution of manipulated quotations of prices of securities and other fraudulent purposes.

The Bill carefully refrains from intruding into the internal management or affairs of the Exchange or from writing into its charter anything that does not strictly concern the integrity of the transactions that are to be carried through the mails. All else is left to the jurisdiction of the States, where it rightfully belongs.

The purpose and effect of this Bill have been grossly misrepresented and misunderstood, as will hereafter appear. It has been said that it involves a censorship of the press and that it interferes with the liberty of the press. It has about the same relation to the liberties or censorship of the press as chalk has to cheese. It is a purely constructive measure. It does not seek to punish for the misdeeds of the past but to prevent and punish their recurrence in the future. It is framed on the theory that the Stock Exchange is an integral and perhaps the most important part of our National and International financial system and that if the abuses such as the manipulation of prices that now characterize its operations can be eliminated its usefulness may be greatly enlarged and it may be made the great public security market of the world to which investors will resort

with a sense of security in the integrity of the transactions there conducted.

It is believed that by requiring full publicity of the facts concerning corporations in the securities of which it is permitted to deal and by banishing and rendering hereafter impossible the illegitimate transactions that now disgrace it and that have destroyed confidence, the investing public will be attracted and a vast amount of legitimate investment business will result which will mean for it the dawn of a new era of prosperity.

Whilst the *ex-parte* statements and the arguments of Counsel before your Committee have served only to emphasize the weight of the sworn evidence on which the House sub-Committee of the Committee on Banking and Currency (the Pujo Committee) acted in recommending the Bill that is now before you, the discussion has been valuable in clarifying and simplifying the issues with which you are called upon to deal.

As the result of this discussion we are confirmed in the view that Federal supervision of the quotations that are listed and dealt in on our Stock Exchanges is essential to the public protection. The only open question is as to how that protection is to be best accomplished.

The champions of the Bill insist that it can be effectively done only through excluding from the use of the mails, telephone and telegraph all quotations on public markets of securities that are not subjected to suitable State supervision through incorporation and under charter and by-laws that in the judgment of Congress will prevent the mails and the agencies of interstate commerce from being used as mediums for the distribution of fraudulent and manipulated quotations. To that end and only for that purpose we insist that the Postmaster-General should be given the power—not to pass upon the sufficiency of the State charter or by-laws of the Exchange, as the opponents of the Bill would have you believe, for there is no such provision—but (1) to perform the formal duty of determining whether the charter and by-laws contain the safeguards that are prescribed by the Bill against the abuse of the use of the mails, telegraph and telephone, (2) to ascertain whether these statutory requirements are being enforced and (3) to examine the books of the members containing entries of their transactions on the Ex-

change (not their other business) as the only possible means of detecting such misuse, so that if such violations exist they may be dealt with by the Courts upon the complaint of the Department of Justice.

It is only where a public security market is not incorporated or where if incorporated its charter does not contain the prescribed provisions or where the provisions are not being enforced that the Postmaster-General can deny the use of the mails to any letter or publication containing its quotations. His are ministerial acts in these respects and should be made subject to review by the Courts.

So, too, in his examination of the books of the members of the Exchange, if as the result of such examination he finds that there have been quotations of "wash sales," "matched orders" or fictitious or manipulated transactions foisted upon the public as genuine transactions, he cannot stop their transmission or interfere with the operations of the Exchange on that account or punish anyone concerned in the fraud if the requirements of the Statute are being met by the Exchange. All he can do in that event is to furnish the evidence thus secured as a basis for prosecuting the guilty parties. The Exchange is not thereby interfered with in its right to continue the use of the mails for its quotations. So long as its charter is in proper form and its charter provisions are being observed its use of the mails is secure. The guilty party alone is reached and his punishment made possible.

By what stretch of construction such a scheme of regulation of the use of the mails can be contorted into a censorship of the press or an interference with the freedom of the press or as "Russianizing the press," it is difficult to understand. And yet the cry has been ingeniously raised and thoughtlessly repeated throughout the length and breadth of the land by a press that is at the moment hyper sensitive of its privileges, that in some way as yet unexplained this Bill would furnish an entering wedge for curtailing the liberties of the press.

Before disposing once and for all of this baseless contention, which is cleverly put forward by the Exchange as a bid for the support of the press in defeating this Bill, permit me to say by way of parenthesis that the power and momentum of the press are increasing at such a rate that the danger is not so much that Congress will ever "Russian-

ize the press'' as that the press may ''Russianize'' the people.

The liberties of the press are in no peril in this press-ridden, press-governed country of ours, where we have no libel laws worthy of the name and where public officials are terrorized, reputations are slaughtered without redress and governmental policies are dictated by the newspapers. Notwithstanding these excesses—which will doubtless be corrected or will correct themselves in time—the liberty of our press is one of our priceless possessions which no patriotic citizen would care to see abridged, even though it is permitted under our lax administration of the law at times to lapse into unrestrained license and to become a serious handicap to the administration of justice. These temporary evils are negligible as compared with the peril of the loss of a free press.

This Bill has no possible relation to the press or its liberties. True, no publication that contains the quotations of the securities of an unincorporated Stock Exchange can have the use of the mails; all that means is that the newspapers shall carry the quotations of only such public security markets as conform to the requirements that Congress considers essential to prevent the dissemination of fictitious or manipulated transactions by which the public will be misled. The press does not and cannot assume any such obligation. It knows nothing of the genuineness of the quotations that it receives from the Western Union Telegraph Company and which the latter in turn takes from the officials of the Exchange. The newspapers are quite as much interested as any other part of the community in the stability of the news and in preventing the dissemination of frauds of the character sought to be reached by this Bill. The same prohibition applies to the use of the telegraph and the telephone and to the dissemination of the information through letters or by any other agency of interstate commerce.

It might as well be said that the exclusion of pictures or literature contained in newspapers that the Postmaster believes to be obscene, or of offers of fraudulent stocks by advertisements or of other enterprises of doubtful legitimacy is an interference with the liberty of the press, for in those cases the Postmaster-General has absolute authority to determine whether the picture or literature or advertisement is proper.

Here he has no such power. If the Exchange has been incorporated and its charter contains the requirements that Congress considers necessary to assure the integrity of the quotations he cannot exclude them unless the requirements are being violated, and his action should be made subject to review, which is not true of any of the existing regulations which I have instanced.

If a newspaper publishes paid matter in the form of "news" and fails so to label it, the Postmaster-General may refuse the use of the mails to the paper as second class matter, which he cannot do under this Bill, even if he knows the quotations to be fictitious or manipulated. If a deceptive advertisement is contained in a newspaper the Postmaster-General may likewise prohibit it the use of the mails. He may absolutely exclude from the mails matter though not fraudulent and not relating to gambling or unlawful transactions which he believes not to constitute legitimate enterprise, as was held in

Public Clearing House v. Coyne, 194 U. S. 497.

In all these cases and in a variety of others that are cited in the discussion of this Bill at pp. 119-128 of the Pujo Report he is the sole judge. Under this Bill he has none of these powers.

Another useful purpose that has been accomplished by the discussion before your Committee has been to force the virtual admission by the opponents of this Bill of the necessity for some sort of Federal regulation. They object, however, to the result being accomplished through State incorporation or through the supervision of the Postmaster-General, but fail to point out any effective alternative. Counsel, speaking for the New York Stock Exchange, suggests that a Bill similar to that under which lotteries were suppressed, that would deny the use of the mails and telegraph for the distribution of fictitious and unlawful transactions would answer the purpose. To me it is manifest that it would be about as valuable as a blank piece of paper. Anybody can detect a lottery ticket but counsel fails to explain how fraudulent or fictitious or manipulated quotations are to be detected unless some machinery is to be supplied for the purpose of safeguarding the mails against being used

for their dissemination. The Boston Chamber of Commerce acting, as I understand, with the Boston Stock Exchange presents a Bill which will hereafter be more fully discussed, proposing Federal supervision but without incorporation and which *would perpetuate the chief evil sought to be abated by this Bill.*

By the terms of this Bill Congress will be satisfied to have the States in which these Exchanges are located place them under State supervision, provided their charters contain certain prescribed provisions safeguarding against fraud and manipulation the quotations that require the use of the mails and telegraph and anything else that the State may see fit to write into them and which Congress does not undertake to dictate or suggest. In response to this moderate proposal it is said that it is an attempt on the part of Congress to dictate the form of the State charter, which is precisely what the Bill painstakingly refrains from doing except in the single particular in which the Federal Government is directly concerned. When it is suggested that the only possible means of ascertaining whether quotations are fictitious or being manipulated is to give to the Postmaster the right to inspect the books of the members for that purpose, we are told that no responsible broker will tolerate any such inquisitorial procedure and that none but clerks would thereafter be members of the Exchange if that necessary and only means of discovering violations of the law were adopted. The opponents of the Bill significantly refrain from enlightening us as to how there could ever be any effective regulation without this privilege.

The right to secrecy from their point of view is not invaded when the Board of Governors of the Exchange, consisting of forty of the competitors of a member are entitled and are constantly accorded the right to investigate these transactions; but it is intolerable when for the purpose of discovering fraud a Government official is to be entrusted with a like power as a condition of allowing a member to use the Government facilities.

The members, besides using these public facilities, have their private telegraph and telephone wires between New York City and the principal Cities of the United States, through which orders to purchase and sell securities come to them from all parts of the country, based on the quotations

that are carried through the mails and over the telephone and telegraph. They require these facilities. They are admittedly essential to the conduct of the business of its members but they resent the proposal that the Government should have any way of ascertaining whether they are being used to mislead the public.

Whilst the Exchange is suggesting a law similar to the anti-Lottery Bill as the limit of Federal regulation, other opponents and many well meaning but uninformed friends of regulation are urging that the Bureau of Corporations or the Department of Commerce or the proposed new Trade Commission be entrusted with the duty of regulating Stock Exchanges as though this were a Bill to regulate the internal affairs of Stock Exchanges, which it is not. Its only purpose is to prescribe the conditions on which such Exchanges may use the mails and telegraph for the distribution of their quotations beyond State lines. So long as they do not require these privileges the Bill does not apply to them. Why the Secretary of Commerce or the Commissioner of Corporations would be as well adapted or more acceptable than the Postmaster-General for the carrying out of the declared objects is not explained except by the fact that the Exchange is seeking to take advantage of a prejudice against delegating any additional powers to the Postmaster-General. That prejudice is in some respects well-founded for he has many arbitrary despotic powers, none of which are subject to judicial review. But it has no application to this case where the regulation has to do distinctly with the use of the mails and the Postmaster-General is accordingly manifestly the only logical and legitimate official in whom the authority should be vested and it should be subject to review.

The position of the Stock Exchange is inconsistent. It insists and has submitted an elaborate argument to prove that the distribution of quotations is not interstate commerce—to which, by the way, we do not agree—and yet suggests as a remedy legislation on the lines of the Anti-Lottery Bills. The Exchange, as before stated, sells its quotations for distribution throughout the country and in foreign countries to the Western Union Telegraph Company, but by the contract between the Exchange and the Telegraph Company they continue under the control of the Exchange wherever they go.

If, as the Supreme Court has held, a lottery ticket and the letters of a correspondence school and a variety of kindred subjects constitute interstate commerce, it is difficult to understand why these quotations do not come plainly within the decisions. This phase of the subject is also fully discussed on pages 119-128 of the Report of the Pujo Committee, where the conclusion is reached that Congress has the power to control the business of these Exchanges and of their members as being engaged in interstate commerce. But this Bill is not framed on that theory for the reason that the control over the quotations is more legitimately dealt with through control over the use of the mails.

Beyond these considerations there is however the further unanswerable reason why the Federal regulation of these quotations, which seems at last to be recognized as essential, cannot be accomplished through the Department of Commerce, the Bureau of Corporations or the proposed Trade Commission, that the quotations are not in all instances those of corporations engaged in interstate business. Many of the most important of the securities dealt in on the New York Stock Exchange and on other Exchanges are those of *intrastate* public service corporations and other *intrastate* companies. Among the securities of that character listed on the New York Exchange there occur to one at the moment such as the Interborough-Metropolitan Company and Brooklyn Rapid Transit Company, which together control the Subway, Elevated and surface lines of Greater New York and will have approximately $500,000,000 of securities listed; the Consolidated Gas Company, which controls the gas and electric lighting systems of Greater New York and is represented by a vast amount of securities; the telephone companies in the various states whose securities are dealt in all over the country; innumerable railroads that are within the boundaries of the different States; mining corporations with hundreds of millions of listed capital that operate within the States where their mines are located and sell their product at the mines so that they do no interstate business and an infinite variety of other great intra-state corporate enterprises. There are billions of dollars of securities of intrastate corporations the securities of which have a broad international market over whose operations this Federal Trade Commis-

sion (which, by the way, has not yet been created) would have no control.

When we come to analyze these various propositions it seems incongruous that in enacting laws to protect the public against being victimized by the circulation through the mails of fictitious and manipulated quotations of prices of securities, Congress should ignore the Department through which such protection can be best accomplished and should consider entrusting the duty to another Department having no logical relation to the subject, merely to satisfy a prejudice against entrusting to that Department the duties for which it was organized and which it is best equipped to perform.

The very astute and resourceful gentlemen who are trying to defeat this legislation by the familiar device of suggesting ways of *not* doing the things that this Bill is intended to accomplish, charge that this is an effort by indirection and through the medium of the Post Office Department to secure publicity and uniform regulation of the affairs of corporations. In proof of that claim they refer to subsections (a) (b) and (i) of Section 1 of the Bill prescribing the requirements of the charters of Stock Exchanges as to the disclosures that must be made by corporations whose securities are to be listed.

They profess to applaud that purpose but say that everything attempted in that direction can be more legitimately accomplished by requiring these disclosures to be made to the Bureau of Corporations or the Interstate Commerce Commission or the new Trade Commission. In presenting that argument they entirely overlook the facts to which we have adverted (1) that these conditions are imposed as necessary to secure the integrity of the quotations for the distribution of which the mail facilities are sought and for no other purpose; (2) that none of these Departments has jurisdiction over the use of the mails or is in any way responsible for the abuse of that privilege, and (3) that the quotations that are to be distributed may be, unless regulated, employed to mislead the public.

The prevention and punishment of manipulation are the chief aims of the Bill.

No matter how complete may be the disclosures made of the affairs of a corporation the public may

be preyed upon if every unscrupulous stock operator or combination of speculators and every pool or syndicate may freely manipulate the securities of that corporation and exploit the public through the unrestrained use of the mails and telegraph. *The public must be protected at the crucial point at which the securities are being marketed* if there is to be any protection anywhere. The argument now advanced that the protection should be applied in the *issue* of the securities by the corporation is a clever effort to obscure and shift the required regulation from that of safeguarding against the manipulation of prices of securities that are already protected by the requirement of publicity to that of the control of bond and stock issues.

It is rarely if ever that the corporation manipulates or deals in its own securities or that it is done on behalf of the corporation. The operation is frequently conducted without its knowledge or connivance, generally by or in conjunction with insiders but often by outsiders.

The wholesome requirements for publicity contained in this Bill furnish *one of the two conditions necessary* to insure the integrity of dealings in the stock. The other condition *of equal importance* is that the market for the stock shall be open and honest, free from manipulated prices. Neither condition can be met by any of the makeshifts that have been proposed or by any means other than that outlined in the Bill. None has yet been suggested.

The proposed Bill submitted as the result of collaboration between the Boston Chamber of Commerce and the Boston Stock Exchange lacks every essential of effective control and would leave the situation worse than it is at present. It represents an attempt to appease the public demand whilst accomplishing nothing. It significantly omits to condemn manipulation, which is the chief evil to be reached, by covering only manipulation *by means of "fictitious purchases and sales,"* "wash sales" or "matched orders." *Manipulation is not accomplished by any of these means* as will be hereafter shown. The only penalty prescribed is expulsion from the Exchange. It should be made a crime. No means are provided for discovering violations. It is the most transparent "make believe." Far better no legislation on the subject until something really effective can be secured. Even in the requirements for listing the most important safeguards are

omitted, such as the exclusion from listing of the securities of corporations whose officers and directors are not prohibited from secretly speculating in its securities. There is not a provision in the proposed Boston Bill that is not now embodied in the rules of the Exchanges in which there now exist the evils that are sought to be corrected. It is a "blind" under cover of which to defeat effective regulation.

The following are some of the chief contributions in the way of irresponsible assertion without proof that have been added to the testimony adduced by the Pujo Committee, during the course of the discussion before your Committee:

(a) The illuminating argument of Mr. Edward D. Page, who was one of the members of the Hughes Commission of 1909 on whose Report the Stock Exchange strangely relies and of which we will hereafter have more to say, in which Mr. Page learnedly descants upon and champions the virtues of "watered stock" as a positive boon to the investing public and in which he deprecates the ignorant prejudice against it that seems to have taken possession of the ill-informed legislative mind.

(b) Mr. Van Antwerp's surprising *non-sequiter* that the effect of any legislation by Congress safeguarding the people against the frauds that are being practiced upon them through manipulated transactions will be to transfer the business to the bucket-shops (p. 153).

We had not supposed and do not believe that of late years at least there is any such close relation between the character of the legitimate business of the stock broker and the dishonest occupation of the bucket-shop. Mr. Van Antwerp's "argument" is an insult to the Exchange. It implies that its dealings are largely gambling and that they involve nothing more than a settlement of differences.

(c) Mr. Van Antwerp's further *non-sequiter* that such regulation would transfer the business of buying and selling securities from the public market of the Exchange to the private bankers.

The two methods of dealing in securities are as far apart as the poles. They always have and always will co-exist and complement one another, just as real property will always be sold privately and at public auction, one being regulated by private barter and the other by public competition.

(d) Another instructive point of view advanced by Mr. Van Antwerp as to the effect of protecting the integrity of quotations through regulation is that the speculative business would go to the London, Montreal and Toronto Stock Exchanges. As this Bill does not interfere with speculation we have here another argument apropos of nothing. If Mr. Van Antwerp means that the speculation that is induced by manipulated prices would go to foreign exchanges I can only say that the sooner that form of activity is transferred to foreign shores the better it will be for our people.

Some Continental countries still maintain Government lotteries. Unlike sales of stock that are induced by the excitement and apparent activity induced by manipulation, these lotteries are doubtless honestly conducted. They are not accompanied by false rumors of impending "deals," new discoveries, increased dividends and the many other devices that have become so familiar but the source of which can never be traced. It is possible that many of our citizens patronize those lotteries because they are unable to buy lottery tickets in this country but that furnishes no reason why our Government should reopen the business of allowing lottery tickets to be sold through the use of the mails.

Mr. Van Antwerp in his excess of zeal to perpetuate the practice of manipulation on the threat that unless the Federal Government continues to lend its aid through the use of the mails it will be conducted through foreign exchanges, fails to take into account the fact that the quotations of those Exchanges may be equally barred from the mails as the lottery tickets of foreign Governments are now barred unless they conform to the requirements that are imposed upon our own Exchanges.

I venture to say that your Committee has rarely had submitted to it anything quite so unsubstantial in the way of "argument" as is this plea of Mr. Van Antwerp.

The purpose of this Bill is to assure and protect the honesty of the public market against the frauds that now characterize it in the form of manipulation which the Stock Exchange still seeks by all manner of specious arguments to defend. Mr. Van Antwerp calls the form of mock auction known as manipulation "stabilizing the market" (p. 121). Other defenders of the system refer to it as "creating a market" or "creating activity". Mr. Milburn apparently is

uncertain whether to defend or condemn it. At one point he argues that there is very little of it and that the Exchange seeks to prevent it, whilst at another he insists that it is permissible and should not be forbidden, as when he seeks to justify such unpardonable transactions as the Hocking pool.

His clients have however no doubt of the entire legitimacy of the practice. Mr. Sturgis said that paying commissions to manipulate a market was like spending so much money for advertising the security. He was quite oblivious of the fact that a man who in the ordinary course of business should sell stock by advertising that so many thousand shares were actually being bought and sold day by day at a given price, and who was actually "going through the motions" and paying commissions on both sides of the transaction for the sole purpose of deceiving would-be purchasers whom he was thereby seeking to attract into the belief that such purchases and sales were genuine, would clearly be guilty of larceny. Yet that is precisely the intent and effect of these manipulated transactions that form so large a part of the business of the Exchange and it is passing strange that the members are so obscessed by self-interest that they cannot appreciate the perfect analogy in principle between the two transactions.

Anyone who is interested in creating an active market in a given security should hereafter be required to frankly set forth his purpose over his own signature, advising its purchase, for which someone can be held responsible, instead of continuing the present underhand methods of false rumors of impending developments, "melons" to be cut, dividends to be increased, large earnings, great market activity (manufactured for the purpose of misleading), etc., that are the accompaniments of "creating activity", "stimulating speculation" and of the various other forms of manipulation.

Successful manipulation of established securities frequently depends on these methods. In order to get the speculative public interested in the stock there must be "something doing" in it. They must be made to believe that they are getting advance information of what is "doing". The whole performance when thus conducted is essentially in the nature of a "confidence game".

The most amazing development of the discussion before your Committee and of the testimony of the officials of the

Exchange before the Pujo Committee was the blind persistency of the Exchange in defending this practice and struggling to retain it, apparently because of the large proportion of the dealings that it represents. They can no more be permitted to continue such practices than they could retain "wash sales" and "matched orders" that until recent years were also regarded as legitimate; nor than they could continue on the list their so-called "Unlisted Department" of blind pools, such stocks as Amalgamated Copper and American Sugar Refining Company, which refused to disclose their affairs and were yet among the most active stocks.

Every important reform looking to the abatement of abuses that were the source of profit has been fairly dragged from the Exchange under threat of subjecting it to regulation.

If I remember rightly, the assertion was made before you that manipulation represented only a small proportion of the daily transactions on the Exchange. There is no proof to support that statement. It is contrary to the facts to be fairly deduced from the mass of statistical and other evidence before the Pujo Committee.

No one can read those statistics of fabulous transactions in connection with the oral testimony and remain for a moment in doubt as to the gigantic scale on which manipulation has been conducted nor as to the hundreds of millions that have been annually taken from the public, and dishonestly taken, by that practice. I refer now to the manipulation in active and established securities and not to that practiced to create an appearance of activity in a new security, which though little less justifiable is not resorted to from the same sordid motives.

The Exchange has presented no facts or figures that attempt to challenge the proofs before you. It contents itself with vague assertion, which by the way, is characteristic of its entire argument before you. An analysis of these statements, *not* made under oath and *not* subjected to the test of methodical cross-examination by anyone familiar with the facts, contrasted with the results accomplished through an inquiry conducted under the forms of law with the aid of counsel, must satisfy you of the unsubstantial and unreliable character of the information secured by the former method. These assertions by the Exchange are further contradicted by the findings of the Hughes Commission of 1909, on which

the Stock Exchange relies, for reasons to us unaccountable; notwithstanding the shortcomings of that unofficial investigation it constitutes a severe arraignment of the Exchange.

Among other things that Commission had the following to say under the heading "Character of Transactions":

> It is unquestionable that only a small part of the transactions upon the Exchange is of an investment character. A substantial part may be characterized as virtual gambling.

It had the following among other things to say under the heading "Patrons of the Exchange":

> The patrons of the Exchange may be divided into the following groups:
>
> (1) Investors, who personally examine the facts relating to the value of securities or act on the advice of reputable and experienced financiers, and pay in full for what they buy.
>
> (2) Manipulators, whose connection with corporations issuing or controlling particular securities enables them under certain circumstances to move the prices up or down, and who are thus in some degree protected from dangers encountered by other speculators.
>
> (3) Floor traders, who keenly study the markets and the general conditions of business and acquire early information concerning the changes which affect the values of securities. From their familiarity with the technique of dealings on the Exchange, and ability to act in concert with others, and thus manipulate values, they are supposed to have special advantages over other traders.
>
> (4) Outside operators having capital, experience and knowledge of the general conditions of the business. Testimony is clear as to the result which, in the long run, attends their operations; commissions and interest charges constitute a factor always working against them. Since good luck and bad luck alternate in time, the gains only stimulate these men to larger ventures, and they persist in them till a serious or ruinous loss forces them out of the "Street".
>
> (5) Inexperienced persons, who act on interested advice, "tips," advertisements in newspapers, or circulars sent by mail, or "take flyers" in absolute ignorance, and with blind confidence in their luck. Almost without exception they eventually lose.

Under the head of "Manipulation of Prices" it had the following to say:

> A subject to which we have devoted much time and thought is that of the manipulation of prices by large interests. This falls into two general classes:
>
> (1) That which is resorted to for the purpose of making a market for issues of new securities.

(2) That which is designed to serve merely speculative purposes in the endeavor to make a profit as the result of fluctuations which have been planned in advance.

The first kind of manipulation has certain advantages, and when not accompanied by "matched orders" is unobjectionable *per se*. It is essential to the organization and carrying through of important enterprises, such as large corporations, that the organizers should be able to raise the money necessary to complete them. This can be done only by the sale of securities. Large blocks of securities, such as are frequently issued by railroad and other companies, cannot be sold over the counter or directly to the ultimate investor, whose confidence in them can, as a rule, be only gradually established. They must therefore, if sold at all, be disposed of to some syndicate, who will in turn pass them on to middlemen or speculators, until in the course of time they find their way into the boxes of investors. But prudent investors are not likely to be induced to buy securities which are not regularly quoted on some exchange, and which they cannot sell, or on which they cannot borrow money at their pleasure. If the securities are really good and bids and offers *bona fide*, open to all sellers and buyers the operation is harmless. It is merely a method of bringing new investments into public notice.

The second kind of manipulation mentioned is undoubtedly open to serious criticism. It has for its object either the creation of high prices for particular stocks, in order to draw in the public as buyers and to unload upon them the holdings of the operators, or to depress the prices and induce the public to sell. There have been instances of gross and unjustifiable manipulation of securities, as in the case of American Ice stock. While we have been unable to discover any complete remedy short of abolishing the Stock Exchange itself, we are convinced that the Exchange can prevent the worst forms of this evil by exercising its influence and authority over the members to prevent them. When continued manipulation exists it is patent to experienced observers.

This argument in favor of certain classes of manipulation was repeated before your Committee by Mr. Horace White and Mr. Edward D. Page, members of the Commission. It was also defended by representative members of the Exchange before the Pujo Committee but was unqualifiedly condemned in the Report.

Counsel now tell us that "it used to be" considered quite legitimate but that there is now a division of opinion on the subject and hence the Exchange has recently (since the exposures of the Pujo Committee) enacted rules to prevent it. On examining those rules you will find that they accomplish

no such result. Under pretense of such rules it is attempting to perpetuate the practice. Besides, if it is defensible, as Counsel and members of the Exchange continue to insist before you in oral statements and in their briefs, why prevent it? Can anyone tell us now after these days of discussion where the Exchange really stands on this crucial question? I confess I cannot, but I can plainly see what it seeks to accomplish here by its tortuous attitude. It wants to make it appear here that manipulation is forbidden in order to defeat legislation and still to be able to insist hereafter when that peril has passed that what it is doing is not manipulation but is something that it has always claimed the right to do.

The fact is that manipulation as now practised on the Exchange and as permitted under their amended rules is dishonest whether resorted to for the purpose of introducing a new security or for any other purpose. True, it is five years since the Hughes Commission made its report and there were many things then tolerated in corporate management and in the financial world generally that would not dare be attempted today, thanks to the exposure of corporate abuses by the muckraking "reformers" and to the improvements in moral standards of business for which their unwelcome activities are responsible. But it is still inconceivable that even in 1929 a body of New York gentlemen as distinguished as were the members of this Commission should have become so permeated with the customs and atmosphere of the financial world in which they moved as to have been led into putting in an official document the statement that manipulation

> which is resorted to for the purpose of making a market for issues of new securities is unobjectionable per se

or that

> It is essential to the organization and carrying through of important enterprises.

It is nothing of the kind. It is distinctly disreputable and the Exchange will shortly be made to see it in that light as they have been taught to see other practices that they once thought to be legitimate.

Is it to be wondered at that no legislation looking to

the correction of the abuses that were pointed out by this Commission followed its report and that nothing was done in that direction until July, 1913, following the public exposure by the Pujo Committee of the same conditions that this Commission privately investigated? Is there any occasion for surprise that there was no abatement of the practice of manipulation in view of the quasi-encouragement lent to it by this Report? It is no exaggeration to say that the bulk of the securities on the list has been at one time or another manipulated—not for the purpose of creating a market or an appearance of activity in a new security, but, as stated in the Hughes Report, either

> to create high prices for particular stocks in order to draw in the public as buyers or to unload upon them the holdings of the operators or to depress the prices and induce the public to sell.

The few instances of manipulation that were discussed at the hearings before your Committee were not the most aggravated cases. That of the California Petroleum Company which was so much discussed was among the least objectionable in form and purpose. It was selected for comment in the Report of the Pujo Committee mainly because it was happening during the taking of testimony.

A case more characteristic of the general purposes and methods of manipulation by reason of its daring and magnitude and of the extent to which the public was victimized is that of the Amalgamated Copper Company. It is a long story that was only partially told before the Pujo Committee because many of the facts were rendered unproveable through the death of Mr. Henry H. Rogers and others that were expected to be established by his partner in the enterprise, Mr. William Rockefeller, were unobtainable because of what was claimed to be the then desperate condition of Mr. Rockefeller's health. It is as stirring as any tale of pirating on the high seas that you have ever read and was practiced by the same insiders over and over again, but there is not time to tell it here. You can read the outlines between the lines of the testimony and statistics that are before you. Time and again the prices were juggled by them up and down from $10 to $50 or more per share to the tune of dealings ranging *from twenty to forty millions*

of shares per year, dependent on whether they wanted to shake out weak holders so as to buy cheaply or put up the price preparatory to unloading the stocks thus "accumulated." High finance would be a comparatively unprofitable industry without the use of the machinery of the Stock Exchange.

The Exchange was a party to it each time in the sense that it lent its facilities to what was neither more nor less than a "blind pool" by permitting vast dealings without requiring information of its assets or earnings or any of the facts concerning it which the Exchange was finally forced to exact, after the harvest had been reaped from the public. Happily, some of those methods are part of the history of the past, but history has the habit of repeating itself. Perhaps there is no such danger under the present alert administration of the Exchange, but it has such a past to live down that it should be patient with those who seek to aid in making impossible the repetition of the past misdeeds.

At the moment the public is wary, and the Exchange is on its good behavior except as to a certain amount of manipulation, which it seems unwilling to prevent and seeks to justify. Recent exposures of financial and Stock Exchange methods have made the public timid. Business is stagnant and all seems serene. It is no time for creating speculative excitement. The old masters of the game of "rigging markets" like Keene and Gates are gone. The times are not propitious to develop the new ones who will take their places. Unless the "industry" itself is stopped, who can tell when others will arise to take the places of those who have passed away or are in temporary retirement waiting for the storm to blow over and who will need their Keenes' and Gates'? Does anybody doubt that they will be on hand unless the inexorable hand of the law has meantime stepped in to protect the ever-gullible public?

The Exchange should welcome the opportunity to be protected against itself.

Unless I wholly misapprehend the operations of our financial system the regulation by law of the Stock Exchange is an indispensable condition precedent to the destruction of the control of great financial credits by a few men or to any effective corporate reform in this country. It *is by* the illegiti-

mate use of the facilities of this, the world's greatest security market, that the vast predatory fortunes have been filched from the public. The relation and importance of the Exchange to corporate independence of banking domination are little understood. We shall accomplish nothing substantial in the direction of the coveted goal of financial emancipation toward which we are striving until this factor is appreciated and dealt with as an essential part if not the most essential factor in the general scheme of reform.

This discussion before you has been conducted on the part of the Exchange as though there were no official data to guide us in determining the extent of the existing abuses and on the assumption that the field of irresponsible assertion is wide open. And so we have been regaled with statements unsupported by proof as to the character extent and methods of dealings on the Exchange that are challenged at almost every point by statistics and by the testimony of the officials of the Exchange, made at a time when they were under the wholesome restraint of having their assertions analyzed by the test of a methodical examination.

The opponents of this legislation seem also to have lost sight of the fact that after months of exhaustive investigation in which the Exchange was represented by Counsel and was afforded the fullest opportunity to present its case this Bill was favorably reported by a Committee of the House of Representatives of the Sixty-second Congress by the unanimous action of the seven Democratic members of that Committee, based upon a voluminous record of sworn testimony supported by documents and statistics.

I quote from their Report on this subject as follows:

> The general public, which has grown to look upon the exchange with distrust because of the practices that have been permitted, will be given new confidence in it when it is under legal supervision.
>
> Notwithstanding these facts it contends that it should be permitted to continue its voluntary organization with the privileges and freedom of action of a private club and should not be made subject to legislative or judicial control or supervision, and that it is not amenable to Federal regulation in its use of the mails and of the telegraph and telephone in interstate commerce and in the dealings of its members with foreign countries.
>
> To this contention your committee is unable to agree. It

is incongruous that such an institution wielding such power and equipped to perform such useful and important functions in our economic system should be uncontrolled by law.

On the other hand, your committee believes that incorporation and regulation would banish from the exchange transactions which now disgrace it, bringing in their place a greater volume of business of an investment and otherwise legitimate character, and marking the dawn of a new era of prosperity for its members and of usefulness to the public.

(*P. 115.*)

* * * * *

In other words, the facilities of the New York Stock Exchange are employed largely for transactions producing moral and economic waste and corruption; and it is fair to assume that in lesser and varying degree this is true or may come to be true of other institutions throughout the country similarly organized and conducted.

Your committee believes, therefore, that Congress has power unconditionally to prohibit the mails, the interstate telegraph and telephone, the national banks, and all other instrumentalities under its control, from being used in executing, negotiating, promoting, increasing or otherwise aiding transactions on such stock exchanges.

(*P. 116.*)

It seems also to have been overlooked that three of the four Republican members of that Committee joined in the recommendation of the majority on this subject in their Minority Report. I quote from the Minority Report as follows:

> Many abuses are disclosed by the evidence produced before the committee, a number of which are well known to the public and recognized by everybody at all familiar with the business conditions in this country. Abuses on the stock exchanges, of quite long standing, were disclosed before the committee, as were also abuses existing in clearing-house associations, especially in New York City.
>
> While existing or both stock exchanges and clearing-house associations could be corrected by the exchanges and associations themselves, if they were so inclined. They having failed and neglected to remedy the abuses existing in their conduct and operation in our opinion it is the duty of each State in which these exchanges or associations are located to compel their incorporation and to regulate their management by appropriate legislation. Should the exchanges and the associations, as well as the various States, neglect this plain and imperative duty, then we believe that it is the duty of Congress to exercise any jurisdiction or power conferred upon the Federal Government by the Constitution to pass such restrictive and regulative legislation as may be neces-

> sary. This duty arises from the fact that these evils are not such as affect only the local communities in which they exist, but their results are as broad as the business interests of the country, and affect in their most intimate and important business relations all the people thereof.
>
> While agreeing substantially with the majority upon many of the abuses to be corrected in the financial system, the stock exchanges and the clearing-house associations, the undersigned have doubts as to the wisdom of some of the remedies proposed by the majority to correct these abuses.

(The last clause refers to other subjects discussed in the Report—not to stock exchanges.)

The opponents of the Bill also ignore the circumstance that the investigation disclosed that the manipulation of prices was regarded and defended by the Exchange as a part of its legitimate business, and that the Committee found the existence of an incredibly deplorable state of affairs which demands prompt and drastic correction for the public protection and which can be corrected in no way other than that proposed by this Bill.

The following language of Chief Justice White in *Lewis Publishing Co.* vs. *Morgan,* decided by the Supreme Court in June 1913, in which the right of Congress was sustained to exclude from the second class privileges of the mail newspapers that did not make certain disclosures, is peculiarly applicable here:

> Under that six-word grant of power (*referring to the Post Roads Clause of the Constitution*) the great postal system of this country has been built up, involving * * * * the suppression of lotteries and a most efficient suppression of fraudulent and criminal schemes *impossible to be reached in any other way.*

The manipulation of prices of stocks is another of the "fraudulent schemes impossible to be reached in any other way."

The operations of the Stock Exchanges was only one of the many topics bearing on the concentration of the control of credits with which the Committee had to deal. It constitutes only one of the 27 separate Recommendations of the Report.

It was accordingly impossible for the Committee within the limited time at its disposal to go further in the taking of testimony on that subject than to present selected instances by way of illustrating the character of the abuses that were being

perpetrated upon the community, but the disclosures made were such as to shock and amaze the country and to demand redress.

On the subject of the manipulation of prices the Committee presented a dozen or more cases, some of them extending over a series of years, but they were selected merely by way of illustrating a general practice. Nothing could better show the perils to a legislative body of relying upon loose assertions made in the course of an informal hearing conducted as were the proceedings before this Committee, where no one is prepared with the material with which to challenge inaccurate statements, than an analysis of a few of the assertions that are made with respect to these official statistics. You are told that they were "selected cases of the most speculative stocks grouped to create dramatic effect" and that "if tables had been prepared to show normal conditions a different showing would have been made." But no such tables are presented, and it is not pointed out wherein these tables are inaccurate. It was within the power of the Exchange to have presented other tables before the Pujo Committee as it was within its power before this Committee to have challenged these detailed figures by *facts*. Instead of doing so it again contents itself with vague generalities and unsupported assertions.

The Pujo Committee could not have presented statistics of the dealings covering the entire 1500 or more securities dealt in on the Exchange, day by day and month by month over a period of from 2 to 10 years as they did in those dozen or more selected cases. It would have required years and would have cost hundreds of thousands of dollars in fees of experts. It naturally selected active stocks as examples of manipulation to establish the existence and something of the extent of the practice. Now we are told that if there had been others they would have disclosed a different state of facts as to the others and that these tables should not be therefore treated as examples of the general practice.

The Pujo Committee was not trying a lawsuit. It was investigating the charge that there was a concentration of the control of credit in this country. The methods of the Stock Exchange were inquired into because of their relation to the general question. It was one of many subjects bearing on that control. The practice of

manipulating stocks constituted one of those methods. There were others equally involved in the general subject of inquiry. Banking control, interlocking directors, holding companies, life insurance control, railroad and industrial organizations, Clearing Houses and a vast number of other topics constituted essential features of the inquiry. It is now argued that in order to show the extent of manipulation the Committee should have traced all the hundreds of millions of transactions affecting every security on the list over a series of years. The statistics presented do in fact trace every transaction in 13 active securities day by day and month by month over a term of years involving as to such securities alone many hundreds of millions of *shares*, and the results are before you. The answer and the only answer to this mass of statistics is—not other statistics, not facts—but the bald unsupported assertion that if the dealings in other securities had been taken *their* dealings would have shown normal transactions. In other words that there might have been found some companies whose securities were not manipulated.

Ergo: There is no such thing as manipulation?

So reckless was the action of the members that the Committee was able to establish (again merely by way of illustrating the extent of the abuse and the persistent unwillingness of the Exchange authorities to interfere with these vicious practices) an operation that was actually being conducted in the manipulation of a newly-listed security day by day on an enormous scale by prominent members with two leading banking houses as allies and associates, *whilst the Inquiry was in progress.*

The details of this particular transaction, which is typical of the method of "making a market" in the securities of a new company but which as above stated is far less aggravated than others that were proven with respect to the manipulation of the securities of established companies, are summarized at pages 50-52 of the Report in the following language:

> *The California Petroleum Co. flotation.*—A typical instance of manipulation for the purpose of stimulating speculation in a new security is the operation in the stock of the California Petroleum Co. begun in October last whilst this investigation was in progress and the subject of manipulation of securities on the stock exchange was under active discussion.

This company was organized in September, 1912, with an authorized capital of $32,500,000—$17,500,000 preferred and $15,000,000 common—of which $11,907,024 preferred and $13,513,081 common was given in payment for the stocks of two California oil-producing companies. (Henry, R., 1251-1253.) Simultaneously, and as part of the plan, William Salomon & Co., bankers of New York, and associates, namely: Hallgarten & Co. and Lewisohn Bros., of New York, and a fourth not named, for $8,215,692 in cash, purchased from the vendors $10,000,000 of the preferred and $7,572,845 of the common stock of the California Petroleum Company, which the latter had accepted in payment for the stock of the two producing companies, William Salomon & Co., Hallgarten & Co., and Lewisohn Bros. each taking 29.1/3 per cent and the unnamed associate 12.1/2 per cent. (Henry, R. 1253, 1255, 1270; Exs. 149-153, R. 1261-1266.)

Thereupon the bankers, as we shall hereafter call them, formed a syndicate in New York to underwrite $5,000,000 of the preferred and $2,500,000 of the common stock at the price of $5,000,000 and sold to a London syndicate the same amount at the same price, leaving the bankers at this point with a profit of $1,784,248 in cash and $2,572,845 in common stock, which latter they sold at 40 and 45. (Henry, R. 1271, 1285.)

The bankers also joined the New York syndicate, in which altogether there were 194 members, including—

(a) Three corporations affiliated with national banks—two of them in New York, one of which had a participation of $500,000 and the other $50,000, and one outside with a participation of $50,000.

(b) One trust company in New York with a participation of $50,000; and

(c) Twenty-four officers of banks, among them officers of four national banks in New York, two in Chicago and one in Detroit, whose aggregate participations were $535,000, the largest single participation—$50,000—going to an officer of a Wall Street bank which lends on stock-exchange collateral. (Henry, R. 1271-1275.)

The stock was all sold at an advance of nearly $500,000 above the price at which it was underwritten on the day it was delivered to the bankers—October 2, 1912—and before any appreciable number of the syndicate had accepted the offer of participation. Thus nearly all the underwriters, including the bank officers, got their profits without having made any commitment, and none of them put up any money or had to take one stock. (Henry, R. 1277, 1278.)

Mr. Henry, of Salomon & Co. who was called as a witness in regard to this transaction, having refused to divulge the names of the national bank officers who received participations in this syndicate, his testimony was certified to the House and from there to the United States attorney for the District of Columbia for prosecution under sections 102, 103 and 104 of the Revised Statutes. Your committee is of opinion that the information sought from Mr. Henry is

germane to the question, Whether national bank officers are being influenced by any form of reward to lend the money of their banks on newly-listed and unseasoned stocks? It was impossible for the Committee without knowing the identity of the banks and officers to determine whether these participations to officers were given for the purpose of inducing the banks they served to accept these new securities as collateral for loans or whether they were so accepted.

The stock of the California Petroleum Co. was listed on the New York Stock Exchange on October 5, after the portion underwritten by the syndicate and the separate holdings of the bankers had all been sold. (Henry, R. 1281.)

Thereafter an operation in the stock was conducted (principally in the common) on the New York Stock Exchange by Lewisohn Bros. for the joint account of the bankers, for the purpose, as described, of "making a market." (Henry, R. 1282, 1283.) Under the general direction of Salomon & Co., Lewisohn Bros. would put in separate orders to different brokers on the morning of every day to sell on a scale up and to buy on a scale down, so adjusted that at the end of the day they would have bought and sold, so far as market conditions permitted, substantially the same number of shares. (Henry, R. 1282, 1284.) There is in the record a table showing the purchases and sales by Lewisohn Bros. and the prices day by day from October 5, when the stock was listed, through the end of that month, from which it appears that during that period of about 21 business days 163,000 shares were purchased and 172,900 sold by Lewisohn Bros. for account of themselves and associates. (Ex. 134 1/2, R. 1186.)

Under the influence of this operation the price of the common stock, starting at about 62 1/2, quickly rose to 72; it had fallen to 50 by December. (Henry, R. 1285-1286.) Mr. Henry, of Salomon & Co., stated that he supposed the public bought largely on the rise. (R. 1286.)

The total purchases and sales on the exchange during these 21 days were 362,270 shares, which was equal to over three and one-half times the total outstanding common stock.

It may be remarked in passing that this stock, which was thus manipulated to $72 per share and distributed to the public has since sold as low as $16 and is now selling at $25.

The Exchange insists that this is a legitimate transaction because it was resorted to for the purpose of "introducing a new security." They say the bankers had sold their stock before this was done and there was no profit for them in this operation. The facts as proven do not sustain them. True the *first* bankers syndicate had sold its stock. But to whom? To the *second* syndicate of which Messrs. Lewisohn were the

managers and the bankers were also members. The manipulation was conducted by the *second* syndicate, which bought 163,000 shares and sold 172,900 shares during the 21 days of its operations. In the same period there were 362,270 shares sold on the Exchange and an equal number of course purchased. What about the dear public that was "landed" with the 199,270 shares that were not represented by the Syndicate dealings, at prices ranging between $60 and $72.50 per share that subsequently declined to $16. and are now selling at $25?

The only comment that would appear necessary in answer to the claim of the Exchange that the disciplining of its members should be left exclusively in its hands without interference or review by the Courts is to refer to the fact that neither in this nor in the many other instances of manipulation uncovered by the Committee was there any effort made to discipline the offenders, except where the operation resulted in insolvency. The transactions were on the contrary sought to be justified. Both Mr. Milburn and Mr. Van Antwerp again defended the California Petroleum manipulation before your Committee as a means of "stabilizing the market." The criticism is not based on the mere fact that the price of the stock has declined. That is a risk incident to all business. Nor is it suggested that this is not a meritorious security. The reputable banking houses that issued the securities would never have offered them if they had not believed in their merit. The complaint is of the devices by which the price was maintained and the public interested.

To my mind these transactions are indefensible. If they can be resorted to for one purpose there is no reason why they should not be justifiable for any other purpose. If it is permissible to create a false appearance of activity and of rising prices in a new security in order to attract people to buy, why is not the same fraudulent device defensible in order to get rid of old securities that have been held or accumulated to be unloaded on the public? Or to depress prices in order to buy cheaply a security that one desires to acquire which, by the way, are the usual forms of manipulation and the purpose for which it is most generally employed? All such transactions amount in effect to a mock auction, with the public as the victims. They are vastly more dangerous and far-reaching than the familiar form of mock

auction because conducted under the cloak of an honorable calling. The following from the testimony of Mr. Frank K. Sturgis, a then Governor and former President of the Exchange is instructive on this point:

> Q. Very well; that is an answer. How do you justify as legitimate the transactions of a pool or syndicate in giving out buying and selling orders to brokers for the purpose of lifting the price of the stock or of depressing it?
>
> A. Those are the acts of individuals. I cannot be responsible for what thousands of people throughout this country do.
>
> Q. Do you seek to justify it?
>
> A. It depends entirely upon circumstances. I have already said that under certain conditions, orders given out, commissions paid, no collusion whatsoever, the broker who buys not having the slightest idea where the order comes from that the broker executes to sell—I say it is not an illegitimate transaction.
>
> * * * * *
>
> Q. * * * Will you be good enough to answer that question? Is not the operation, at times, resorted to to depress prices, and at other times to lift prices?
>
> A. Yes; I can consistently answer that.
>
> * * * * *
>
> Q. You approve of those transactions, do you?
>
> A. I approve of transactions that pay their proper commissions and are properly transacted. You are asking me a moral question, and I am answering you a stock-exchange question.
>
> Q. What is the difference?
>
> A. They are very different things.
>
> Q. I thought so. There is no relation between a moral question, then, and a stock-exchange question?
>
> A. Sometimes.

Another witness (Mr. Morse at p. 719) described the mechanism of manipulation as practiced on the Exchange as follows:

> He is the gentleman who manipulates the stock, giving the buying and selling orders. (Morse, R. 710.)
>
> If he merely wishes to make a stock appear active, he gives buying and selling orders in about equal volume; if he wishes to put up the price, he gives an excess of buying orders; if he wishes to depress, he gives an excess of selling orders. (Morse, R. 710, 711.)

There is not time to rehearse here the innumerable ways in which the machinery of the Exchange is shown by the testimony to have been used with impunity over a long series of

years and up to the conclusion of the Inquiry for the practice of deception upon the public.

The cases of the Columbus & Hocking Coal & Iron pool, Rock Island and California Petroleum Co., described at pages 47 and 50 of the Report, are further illustrations of one of the many phases of the evil to which I refer.

Suffice it to say that there is overwhelming evidence to support the findings of the Committee. The testimony comes, not from hearsay nor from muckrakers or enemies, but from the lips and the records of the members themselves. The Exchange was represented before the Committee by the same eminent Counsel who appeared before you, as astute and resourceful as any in the land, who submitted a lengthy printed argument dealing with every phase of the law and facts. The witnesses who testified to its general methods and practices were *selected by the Exchange* at the invitation of the Committee and they were afforded the most ample opportunity for explaining and supplementing their testimony.

There is no basis for the impression that the Exchange, through its press bureau, has industriously sought to create, in order to excuse the exposure of its methods that came from the lips of its own officials who were selected by it for the purpose of presenting its defense, that there was anything unfair or one-sided about the manner of the Inquiry. Here again it is intimated that the Exchange did not have the opportunity to present its case and that the Committee selected the witnesses. This is not a just or accurate statement, as will be apparent from an examination of the record.

Never was an investigation conducted with greater fairness or generosity to those concerned nor with so strict an adherence to the rules of evidence that would be applied in a court of law. Every witness whom the Exchange asked to have examined was called, it was invited to submit whatever questions it desired to have asked and *all such questions were put* and every witness was given the opportunity to examine and correct his testimony and to make such additions, explanations and statements as he chose at the conclusion of his evidence. All the arguments that have been presented to you by the Exchange in defence of its practices will be found in one form or another in the record of those proceedings. Nothing that Counsel for the Exchange asked to have read into the record or asked of the witnesses (who were their own officials,

selected by them) was omitted. Availing himself of that permission, Mr. Sturgis delivered a carefully prepared Address, which will be found at the end of his testimony. I do not deem it necessary or appropriate to enter upon a defense of the fairness of an Inquiry by a Committee of the House of Representatives against the irresponsible and unfounded attacks that were inspired in the public prints. The record and the unanimity of the conclusions reached by the Committee regardless of partisan lines speak for themselves. The Exchange had to say something by way of apology for the amazing exhibition that it made and this was all it had to offer.

In the face of the record accompanying the Report of the Pujo Committee it is worse than idle to assert that the Exchange will ever be able to bring about its own reformation. Its unaccountable insistence upon continuing the practice of manipulating prices of securities leaves no room for argument. The practice amounts to a continuing inducement to the public to buy and sell under false representations.

The amazing figures presented by the diagrams at pages 1120-1178 of the Report indicate that manipulation is the rule rather than the exception, that nothing short of legal regulation and restraint will ever be effective and that there must be adequate legal machinery for uncovering the offenses.

A few further quotations from the testimony of Mr. Sturgis will give a fair idea of the prospect for reform in that direction:

> Q. We are speaking of transactions that are made by members of your exchange in the way of short selling. Would not their books show whether or not they were selling short?
>
> A. If the broker is operating for his own account, yes.
>
> Q. And you say from a quarter to a half of the transactions on the exchange are for the broker's own account?
>
> A. We agreed upon a third, I think.

Another of the notorious instances of manipulation in the recent history of the Exchanges was that of the Hocking pool in 1909, of which the late James R. Keene was manager, the operations of which will be found described on pages 47-49 of the Report. Ten Stock Exchange firms participated in it. The stock which was earning only one-half of one per cent was forced up from $24 to $92.50 per share.

The entire number of shares listed was 63,304. In a single month (March) when the pool operations began 113,400 shares were traded in. Upon the termination of the pool the stock declined to $2 per share and then disappeared.

More remarkable even than the neglect of the authorities of the exchange to stop this operation when they knew it was going on, was the theory on which they inflicted "punishment" after the pool collapsed. Of the 10 firms engaged in the pool, only the three that failed were punished. They were expelled from the exchange. The others were neither expelled nor suspended, but merely "censured". Thus the punishment was inflicted, not for the character of the operations, since all were equally culpable in that regard, but for becoming insolvent in consequence of dealing beyond one's means.

This was admitted by Mr. Sturgis (R. 846):

> Q. I should like to know why you should expel two members of a pool out of seven stock exchange firms for doing the same thing that the other five did simply because these two happened to fail to?
>
> A. Because they went away beyond their means.

Mr. Sturgis further stated that the members of this pool who did not fail were not punishable under the constitution of the Exchange for the character of operations in which they engaged and that he did not think they ought to be (Sturgis, R., 846, 847):

> Q. Do you mean to say that the things those seven firms did were not punishable under the constitution?
>
> A. No; they were not punishable.
>
> Q. Do you not think they ought to be?
>
> A. We have not thought so heretofore.
>
> Q. Do you not think so?
>
> A. I do not think so; no.

There has been much discussion of the relative merits of and objections to "short selling" and speculation generally, on moral and economic grounds. I do not propose to enter upon that discussion at this time.

This Bill is not intended to prohibit speculation.

That might be accomplished by the Federal Government by indirection through the taxing power, with ample Constitutional warrant based upon judicial precedents. But this Bill attempts nothing by indirection. It

seeks only to prevent the use of the mails, telegraph and telephone in aid of *fictitious* transactions and *dishonest* speculation. It does not attempt to prohibit short-selling. Insofar as its effect is to limit short-selling the result is brought about incidentally and indirectly through prohibiting practices that bear directly upon the integrity of the quotations that are to be distributed through the mails.

The following extract from Mr. Sturgis's testimony fairly represents the Stock Exchange view of short selling and the arguments that are advanced to support it, (Sturgis, R. 830, 831, 832, 833):

> Q. Certainly. What is the purpose of short selling?
> A. Generally speaking, to make a profit.
> Q. To make a profit by what process?
> A. By repurchasing the short sale at a declining price.
> Q. That is, by selling a security that you have not got and gambling on the proposition that you can get it cheaper and deliver the thing that is sold? Is not that it?
> A. That is the usual process—selling when you think the price is too high and repurchasing when you think it has reached the proper level.
> Q. But is it, or not, the process of selling a thing you have not got?
> A. It is.
> Q. And is it, or not, with the idea that it will go lower, or can be depressed lower, and bought cheaper and delivered?
> A. Truly.
> Q. Do I understand that you regard that as legitimate and defensible?
> A. Do you wish my personal expression of opinion?
> Q. Yes.
> A. I think it depends entirely upon circumstances.
> Q. Under what circumstances would you regard that sort of short selling as legitimate and proper?
> A. I would regard it so if there was a panic raging over the country and it was desirable to protect interests which could not be sold. I think it would be a perfectly legitimate thing to do.
> Q. Let us see about that. If there was a panic raging over the country and a man sold stocks short, would not that simply add to the panic?
> A. It might. Self-preservation is the first law of nature.
> * * * * *
> Q. But, as I understand it, if there is a panic raging over the country, you think it is defensible for a man to depress stocks by selling stocks he has not got, with the idea of adding to the panic?
> A. Mr. Untermyer, if a person has property which is absolutely unsalable and he can, so to speak, protect his

position by selling something for which there is a broad market——

Q. That he has not got?

A. (Continuing). I do not consider it wrong.

Q. Mr. Sturgis, let us just analyze that, because I do not think I understand you. You do not want to be misunderstood, do you?

A. It is not my wish.

Q. And I do not want you to be misunderstood. Do you mean to say that in a panic raging it is a defensible thing for a man, under any circumstances, to sell stock that he has not got, with the idea of getting it back cheaper?

A. I do think it is defensible. I certainly think it is defensible.

Q. For what purposes does he do that except to try to make money?

A. To try to save his credit, perhaps.

Q. How does he save his credit in a panic by selling stocks that he has not got, with the idea of adding to the panic and getting them cheaper?

A. Because if he can make a profit on that sale it may repair the losses that he has made on stocks he cannot sell.

Q. I see. You know that that would simply accentuate the fierceness of the panic, do you not?

A. It could not be otherwise.

Q. Certainly. And his only purpose in doing a thing of that kind in time of panic would be to make money, would it not?

A. To protect himself.

Q. It would be to make money, would it not?

A. Yes; and that would protect him.

Q. Of course it always protects a man to make money, no matter how he makes it, does it not?

A. Yes, sir.

Q. And that, you think, is justifiable?

A. I think under those circumstances it is.

Q. You do not want to make any further explanation of that proposition, do you?

A. I do not.

Q. Is it any more justifiable for a man to sell short in a panic than in a normal market?

A. It depends very much upon his financial necessities.

Q. Do you regard it as justifiable in a normal market for a man to sell a thing he has not got, with the idea of depressing prices in order to buy in the stock at a lower level?

A. I think it is a question between a man and his own conscience.

Q. I am asking for your judgment. You have been many years in the exchange, and you are a careful observer, and I would like to know your judgment.

A. I think a great many people deprecate it. Others approve it.

Q. Do you approve of it?

A. You ask me personally?

Q. Yes.

A. I never sold a share of stock short in my life.

Q. Then you do not approve of it, do you?

A. I just happen not to have done it. My private business, if you please, I beg you to omit.

Q. I have not asked you your private business.

A. Yes; you asked me what I did myself.

Q. I did not ask you that, sir; I asked you what you thought about it.

* * * * *

Q. Do you approve of short selling in others?

A. Under what conditions?

Q. Under any conditions.

A. Yes; under some conditions.

Q. Do you approve of short selling in a normal market?

A. I will answer that question by saying it is a moral question with the individual himself. It is not up to me to express my opinion upon it.

Q. Do you personally approve of short selling in a normal market?

A. Not I, personally; no.

Q. You do not. And is it or not the fact that the bulk of the short selling is done in a normal market?

A. I should say no; more often on an excited market.

Q. It is done every day, is it not?

A. Oh, yes; to some extent.

Q. And it is done in large volume, is it not?

A. At times.

Q. The stock exchange does not discourage it, does it?

A. The stock exchange does not enter into it at all.

Q. The stock exchange does not discourage short selling, does it?

A. The stock exchange takes no position in the matter at all.

Q. Has the stock exchange any rule or regulation against short selling?

A. None.

Q. Why is it not just as simple a matter for them to have a regulation against short selling as to have a regulation against a broker splitting his commissions?

A. There is no regulation against short selling; that is all I can say to you about it.

My reason for declining to enter upon the discussion of the relative evils and alleged compensating advantages of speculation and short-selling is that they have only a remote relation to the purposes of this Bill and I am anxious that the real issues shall not be obscured. Judging by the prominence that the representatives of the Exchange have given to the discussion of those purely collateral and largely academic ques-

tions, it looks as though they are anxious to create a false issue by setting up a wooden man and proceeding to knock him down. I decline to follow them upon that quest, however tempting may be the inducements.

This Bill is aimed at *dishonest* speculation through manipulation whether for the long or short account. It is employed equally to raise and to depress prices. The methods in both operations are equally deceptive.

I may however be permitted to say in passing that the champions of short-selling studiously ignore the main argument against its legitimacy. They insist that it is a safety valve against undue inflation and depression, in that it tends to check an undue rising and falling market in a security.

It is said that the short-seller sells when in *his* judgment a stock is too high and is compelled to cover his sale by buying when it has reached what he believes to be its real value. That sounds well in theory. In practice short-selling is a dangerous factor in times of depression. It is a direct incentive toward creating and accentuating panics in the security market.

But above and beyond this, it is not in fact to any extent employed, as is claimed, as a test of the value of a given security, and does not in practical operation perform any such useful function, except in rare cases. Speculation is the main feature of the stock market. The bulk of its transactions are in the nature of gambling, the brokers being themselves and for their own account the chief speculators and the customers who trade through them buying and selling from day to day making up the remaining speculative contingent.

A "short-selling" movement is not ordinarily directed against a particular security on its merits. In order to be successful on a substantial scale it attacks the entire market. The operator sells, without owning, a number of the most active securities on the list without regard to their merits or whether they are intrinsically worth more or less than their then selling price. There is rarely a substantial selling movement that does not attack and depress prices in the active stocks all along the line. The market prices move up and down by sympathy. That being true, explodes most of the fine-spun theories as to the justification for short-selling in fixing and steadying the value of a given security.

The demand of these gentlemen that they be further entrusted with the task of self-reformation, is an unthinkable proposition. If the practices they are struggling to retain, such as manipulation of prices, are to be hereafter prohibited as unlawful, the suggestion that the machinery for uncovering the offense and the punishment therefor be left exclusively in their hands to deal out justice to one another is certainly unique, to say the least. The absurdity of the contention is emphasized by the tenacity with which they cling to the delusion that manipulating prices is legitimate business. Not more so, however, than the further argument of the Exchange that it is now mending its ways and that there should therefore be no means provided by the law for discovering or punishing future offenses. Truly a most remarkable process of reasoning!

If a member divides any part of his commissions with his customer or with any one through whom he secures business, expulsion and ruin are the immediate results.

> "Splitting commissions is the most heinous offense a member can commit,"

says Mr. Sturgis—far more heinous than "wash sales" or fraud. One would imagine that these gentlemen would have sufficient sense of humor to pause in their denunciation of the motives of those who have dared suggest that they have not quite demonstrated the justice of their demand that they be permitted to continue free from the legal regulation and restraints that pertain to other occupations affecting the public. It is difficult to imagine what motives there could be for the performance of this unpleasant duty other than the public interest and to promote the eventual usefulness of this great financial agency.

The extreme gravity and importance to the public of the transactions conducted on the Exchange are little understood outside the very restricted circle that has to do with large corporate business. Even to the latter the mechanism of the Stock Exchange and the way in which prices are made are largely a closed book. They are technical and complicated in the extreme, which accounts for the endless opportunities for misrepresenting the issues and misleading the public.

Incorporation and rigid regulation of the Exchange have become essential to the public protection. They will vast-

ly add to the value and stability of meritorious securities and to the usefulness of the Exchange as a legitimate and necessary part of our financial system and they furnish the only means of preventing deception in the quotation, purchase and sale of securities on public Exchanges. I claim that there can be no effective regulation without incorporation, nor without the accompanying all important power to inspect the books of members of the Exchange insofar as concerns the transactions on the Exchange. In making this claim it is not necessary to impugn the purposes of the general body of membership of the Exchange. Nor am I unmindful of the efforts that the Exchange, under the spur of the criticism aroused by these exposures, has recently been making to correct existing defects in its management in certain directions nor the inherent difficulty in bringing about reforms, but the chief abuses remain and so it will continue until the law renders them impossible by making them punishable as crimes and providing means for their discovery.

My contention is that without the aid of incorporation the Exchange will be unable to put an end to illegitimate practices and that the best element in its membership, whose business does not depend upon these practices, should welcome the proposed legislation instead of short-sightedly arraying itself with the other element against public sentiment and opposing every measure that is intended to restore and maintain public confidence, on the mistaken theory that the Exchange must be permitted to continue to be a law unto itself.

This contention is supported by the judgment of an eminent an authority as Mr. George W. Perkins, who was for many years a partner in the firm of J. P. Morgan & Company. The following is from the testimony of Mr. Perkins on this subject before the Pujo Committee (pp. 1625-1626):

> Q. Have you, as a result of your experience, any opinion as to the necessity or advisability of putting the stock exchange under legal control and regulating it?
>
> A. Yes.
>
> Q. What is your view as to that, and what are the reasons for it?
>
> A. I feel generally, from such study as I have made of that, that if the exchanges were incorporated under some legal system of regulation that it would inure to the benefit of the people who are investing in securities sold there and would be more to better for the public who are the buy-

ers, and for the members of the exchange who are conducting this business.

Q. You favor the incorporation of the stock exchange, do you?

A. I would: yes.

Q. And under what laws do you favor its incorporation?

A. I know that the feeling among some people with whom I have talked is that it should be incorporated under the laws of the State of New York. The New York Stock Exchange was organized a great many years ago as a New York enterprise, but personally I think it has largely outgrown that function. It is a national institution now. In fact, it is more than that. It is an international institution.

Q. It is an international institution?

A. Yes; and people are trading in its securities who are many thousands of miles away, and they should be given all the protection in that trading that it is possible to throw around it. I believe a very vast sum of money would come as an investment in American securities, if some of the conditions in regard to the manner in which they are traded in could be changed and perhaps improved to the benefit at once of the exchange and to purchasers.

Q. Is it your judgment, then, that it should be incorporated under a Federal law?

A. That would be my judgment, if it could be so arranged. In fact, I am a nationalist on almost all of these questions, not a State rights man.

Q. Does the stock exchange perform any important function in national finance?

A. I think it does, very; and a most useful function.

Mr. John Aspegren, President of the Produce Exchange, testified as follows before the Pujo Committee (pp. 929-930):

Q. Your exchange is incorporated under the laws of the State of New York, is it not?

A. Yes, sir.

Q. Do you find any difficulty in doing business as an incorporated exchange?

A. No; we do not.

Q. Do you find it handicaps you in any of your legitimate operations?

A. That depends on what you mean by "legitimate" operations.

Q. I assume your operations are all legitimate.

A. That is why I asked the question.

Q. It does not hamper you in the pursuit of any of the legitimate operations of the exchange, does it?

A. It may bring out lawsuits. I think we have had some.

Q. You mean it gives a remedy to people who claim they are injured by your acts?

A. That is exactly it.

A comprehensive understanding of the complex machinery by which prices are controlled is necessary to form

a judgment on the question. This knowledge is of far greater importance to the masses and in more ways than is generally appreciated. Those who have never bought or sold or owned a bond or share of stock, and never will, are as deeply concerned in the rigid regulation of this vast instrumentality of finance as are those who deal in the securities that are listed on the Exchange. Their interest will be found not only in the close relation between fictitious values of securities and the prices of the commodities of the Companies represented by these securities but in many public aspects of the subject connected with its quotations of securities.

But for the incentives and opportunities offered by the Stock Exchange most of the great Trusts would have been impossible.

The attraction to the vendors of the properties lay largely in the opportunity offered of selling the securities received in payment for their properties to the public. This was made possible only through the medium of the Exchange. To those who continued to hold their securities, inflated prices for the commodities meant higher dividends, thus further increasing the market values of their securities; the control of the market for a given product with the accompanying power to levy tribute on the public is capitalized at all that the traffic will bear and the securities representing no actual property and nothing but this artificial control, find a ready market on that basis. In order to support the fictitious values thus created that control must at all hazards be maintained.

The merits of the controversy over this question of whether the Stock Exchange should be required to incorporate and be subject to regulation have, with few exceptions, been unrecognizable from the newspaper reports.

The Exchange maintains a publicity department under the euphonious title of the "Library Committee". In the course of the hearings before your Committee there was distributed from Washington and published all over the country a canard to the effect that the President had expressed his disapproval of the Bill now under discussion. So persistent and circumstantial was the rumor that an explicit denial from the White House was considered advisable to prevent the discrediting of the legislation.

Such methods are most unfortunate. They are bound

sooner or later to react against the Exchange and thus obscure the merits of the controversy, which the champions of this measure are anxious to have impartially and impersonally discussed.

In answer to the question: Why should the Stock Exchange be incorporated? We might with far greater justice ask: Why should it not? It is today the most powerful and far-reaching of all the instrumentalities of National and International finance. Its records, whether genuine or fictitious, honest or juggled, are the guides by which transactions are conducted and values fixed by millions of people here and abroad. Its vast and delicate machinery, with its endless opportunities for the perpetration of fraud and pillage (unfortunately too often accomplished in the past) should not be in the uncontrolled, unregulated and irresponsible power of any body of men, however unselfish and altruistic may be their aims.

Without yielding here to the temptation to rehearse the history of the past fifteen years of the Exchange as the instrumentality by which vast fortunes have been filched from the public through the absence of control over its operations, it is sufficient to remind you at this point that the plea for incorporation and regulation involves no reflection upon the Exchange or its membership.

Why should any public utility or instrumentality be subjected to control? Why should banks, trust companies, life and fire insurance companies, casualty, accident, burglary, insurance and other industries that might equally well be conducted by individuals be required to be incorporated? Why should not you or I have the right to insure lives or property if we are considered sufficiently responsible and otherwise acceptable by those who are concerned? There was a time when this was permitted. It is no reflection upon your honesty or mine that these things are no longer tolerated in any civilized country.

Why should auctioneers who buy and sell any kind of personal property, except securities, require licenses and have their books of account and all their transactions subject to public inspection, whilst the brokers who deal in securities are free from such inspection? Is not such a broker an auctioneer in the largest and broadest sense? How does a manipulated stock transaction differ from any other

kind of mock auction? You imagine that you are purchasing in an open competition in which true values are fixed when in fact the cards have been stacked against you.

Why are the books of employment agencies, hotels, boarding houses, etc., now required by law to be subject to public inspection? Why are barbers, plumbers, pharmacists, liquor dealers, warehousemen, steamship ticket agents, public accountants and innumerable other occupations required to be licensed and regulated?

I mean no disrespect to the calling of the stock broker and suggest no comparison except in the principle involved in asking why the pawnbrokers should be open to the inspection of the public authorities if, as is now claimed, there is no power to compel the transactions of brokers on an open board to be subjected to examination by State or Federal authority. There is no argument in support of the Constitutional power in the one case that does not apply to the other.

They are all conducting legitimate business, but the right to regulate them like that of dozens of other industries that might be named, is recognized. Their occupations may be more humble than that of the stock broker in the sense that the transactions may not be of such magnitude, but they are quite as legitimate.

It was suggested on the hearing that as everybody in business uses the mails the argument in favor of requiring the Stock Exchange to incorporate under a form of charter to be dictated by Congress might be urged with equal force against all business, thus interfering with the sovereignty of the States in the granting of charters and by implication transferring this power to the Federal Government.

The answers to this suggestion may be summarized as follows:

1. The Bill, as hereto stated, does not prescribe the form of charter except insofar as necessary to protect the mails against being used as the agency for the perpetration of frauds upon the people of the country. In all that pertains to the internal management of the organization, its powers, restrictions, and obligations the State writes its own charter. All that Congress asks is that the state shall give to the Federal Government the assurance of State supervision and such protection as Congress regards as essential to the purposes of the mails and telegraph.

2. Congress would have the right if it saw fit to go much further and to demand that the Exchange take out a Federal charter or license as a condition of using the mails for

purposes of such far-reaching importance and involving such potentialities of national injury. The Stock Exchanges of New York, Boston and Chicago are institutions of National rather than of State concern. Congress has by this Bill left their government to the State when it might justly have itself assumed control.

3. If the necessity for regulation that is here shown to exist, could be established with respect to any other business it would be not only the right but the duty of Congress likewise to protect the mails from being made the agency for the perpetration of fraud. The provision of the Sherman Law for the seizure and confiscation of the goods of an unlawful combination in interstate transit is an instance of the exercise of that power. The Pure Food Law is another. Whether it is *advisable* for Congress to exercise its authority in a given case is a question for it to determine but the *existence of the power* to exclude from the mails matter that is not safeguarded in the manner that Congress may deem necessary, cannot be open to question. It may say tomorrow that the results of horse races shall not in any event be carried by the mails or over the telegraph or that they shall be carried only where the races are run under the control of corporations expressly chartered by the State and where gambling is not permitted.

The Federal Government is not bound to permit its agencies and facilities to be used for purposes that Congress believes to be immoral or fraudulent. So long as every State and every citizen receives equal treatment there is no ground for complaint.

4. There is no way of enforcing uniformity of regulation with respect to the conditions on which the mails and telegraph shall be used by the Exchanges for the distribution of quotations except by Federal law which shall prescribe *in that respect* in their charters the conditions under which securities are to be listed, quoted and dealt in. The alternative is as between State and Federal incorporation of the Exchange. To require Federal incorporation would involve placing the internal management of the Exchanges under Federal control, which is neither necessary nor advisable. To attempt regulation without incorporation would impose upon the Federal Government the unwelcome and unwise task of supervising the listing applications of intra-state as well as inter-state corporations the quotation of the securities of which are being distributed through the mails, all of which is avoided and properly left to the jurisdiction of the State under this Bill.

The reasons in favor of regulation and control of the Exchange are vastly more weighty than those appertaining to any of the above-enumerated occupations that are now regulated and controlled. The Exchange is in no sense a private or local enterprise. It is grossly misleading to say, as has been argued by the defenders of its present irresponsible

form of association, that it is not engaged in business and that its only function is to provide a meeting place where its members may deal with one another under prescribed rules.

The Exchange is engaged in business and of a highly important and distinctly National character. It owns the entire stock of the New York Quotation Co., which for a specified rental, supplies members' offices south of Chambers Street, New York City, with a ticker service that registers, impartially and without earmarks, every genuine and manipulated transaction that takes place on the floor of the Exchange. For $100,000 a year, under contract terminable upon one day's notice, it sells these quotations to a subsidiary of the Western Union, the Gold & Stock Telegraph Co., which also maintains a like ticker service. The latter, however, can supply the quotations *to such persons only as the Exchange approves* and under no circumstances to members' offices south of Chambers Street or to any competing Exchange in New York City. The quotations are gathered upon the floor of the Exchange by its employees and transmitted by its own operators to the officers of the New York Quotation Co., and the Gold & Stock Co. and thence distributed throughout the United States, but the Exchange retains the right to determine absolutely who shall and who shall not receive these quotations. There is no other method by which quotations of transactions on the Exchange are obtainable.

It is the market place of the entire country and of foreign countries for securities and the only public market in the United States where money is loaned and borrowed.

The business transacted by its members has no relation to State lines. It comes to them from almost every corner of the civilized world. It is not only nation-wide, but international in scope. Its members maintain private wires to all the principal Cities of the United States and the transactions conducted on this open Board are for the account of customers from all parts of the country and from foreign countries.

Its hall mark as to the genuineness of a certificate of interest in a corporation passes current everywhere and it is rightly supervised with jealous care and at considerable expense to the corporations concerned.

It undertakes to prescribe the form and conditions of every corporate security in which it authorizes dealings and

its determination is final through its control over the listing of such securities. It reserves the right to exact the minutest details of the business and affairs of the issuing corporation, to impose its will in the matter of the procedure by which such corporation shall declare and pay interest and dividends and in the matter of the transfer agents and registrar and as regards endless other details; all this very properly on the ground that it is performing a public function national in its scope.

It jealously controls the reports of every transaction on its floor, issues and distributes the records of every purchase and sale, or offer of purchase and sale, which it thereby impliedly represents as an honest and genuine transaction. Courts of Justice, Trustees, financial institutions, tax officials, State Superintendents of Banks, Trust Companies and Life Insurance Companies and other corporations that are subject to supervision in the several States throughout the country, and the Comptroller of the Currency in fixing the value of securities of National Banks, and the public the world over, act on this information. It exacts compensation for the service of listing securities, sells the quotations to interstate and international telegraph companies for large sums of money and scatters them broadcast through the newspapers, over the telephone and telegraph, but always under its control.

In the face of this array of undisputed facts, this stupendously powerful National and International agency of finance contends that it would not be a reasonable or legitimate exercise of the power of Congress to prevent the use of the mails, telephone and telegraph in interstate business as a means of perpetrating frauds upon the public. Congress not only has the unquestioned power—it has become an imperative duty. It is a necessity of modern finance from which there is no escape. It is far more important than the power now exercised by the Post Office Department over letters and prospectuses that are circulated through the mails, under which there have of recent years been so many wholesome convictions for fraudulent use of the mails.

Regulation through incorporation is not only needed as a preventive of fraud. It will accomplish still greater results as a constructive measure.

Great and much-needed reforms in the organization and methods of our corporations may be legitimately worked out

through the power wielded by the Stock Exchange over the listing of securities. Much of the confusion and many of the defects in corporate regulation due to the diversity of State laws and to the bidding of the States against one another in laxity of administration in order to attract corporations within their borders may be corrected and uniformity of methods introduced through the Listing Department of the Exchange.

Thus complete publicity as to all the affairs of a corporation may be uniformly enforced. It may and should require as a condition of listing a security that all the intermediate profits and commissions of bankers, brokers and middlemen shall be fully disclosed, thus throwing about the investor the protection afforded by the "Companies Act" of Great Britain and of other civilized countries. Every new security should be required to be publicly issued and offered to the public through the publication of a prospectus so as to eliminate the secret profits of the middleman as far as possible. It is the only way to create confidence in and to popularize investments in corporate securities.

Detailed annual statements should be exacted from all corporations whose securities are listed, disclosing all payments made or profits or emoluments received, directly or indirectly, by officers, directors, bankers and brokers from the corporation, so that every security holder may know whether and to what extent his Company is being exploited.

The scandalous practices of officers and directors in speculating upon inside and advance information on the action of their corporations may be curtailed, if not stopped, by requiring that the officers shall make full disclosure of all their transactions in buying and selling securities of their Companies. The Act incorporating the Exchange should provide that all statements required to be made by corporations shall be under oath and that false swearing shall constitute perjury. At present they are extra-judicial.

In short, the opportunities of the Exchange as an agency of corporate reform are almost endless, provided its own practices can be reformed so as to entitle it to exercise these broad powers. Instead of the investment business of the country abandoning the Exchange as it now and has been to an extent the case for some time past, it will become necessary to the reputation and saleability of a security that it should be listed by reason of the protection thereby afforded

the investor. The general public, which has grown to look upon the Exchange with distrust because of the practices that have been tolerated in the past, will be given new confidence in it when it is under legal supervision.

The argument as to the effect of this legislation in enlarging the usefulness of the Exchange has been referred to as an admission that the ultimate purpose is to secure publicity and uniformity in corporate transactions and general corporate reform through the use of the Post Office Department. It is nothing of the kind, although it would not be a misfortune if it should indirectly lead to uniformity in requiring publicity of the affairs of corporations and to restricting the bidding of the States against one another in laxity of administration. If it incidentally reduces the incentives for the organiaztion of "carpet-bag" and "wild-cat" corporations it will hardly be objectionable on that ground if it is otherwise a legitimate exercise of power.

It is as essential to protect the mails against being used as an agency for facilitating the perpetration of fraud to require that the public market whose quotations are to be carried by the mails shall be restricted to the listing of securities that conform to given requirements of publicity of their affairs as it is that the quotations of those securities shall represent only actual and not fictitious or manipulated transactions.

There is no ulterior purpose in the first requirement, even though it may serve another useful purpose. The intended protection of the public cannot be secured without compliance with both requirements.

The principal objection urged by the Exchange against incorporation is that it will interfere with its power of discipline over its members and thus lower the existing standard which it is claimed can only be maintained by reposing unquestioned and summary final authority in the Board of Governors.

No such interference in the internal affairs of the Exchange is involved. As before stated, this Bill does not undertake to deal with the form of charter or conditions of membership. The State will preserve the present power of discipline if in its wisdom that is deemed to be for the general interest. So it will, if it sees fit, permit the Exchange to re-

tain its present limit of membership and its right to require that its members charge a uniform rate of commission. These, among other things, are matters with which Congress has no concern. I have never been able to persuade myself of the sincerity of this plea against incorporation. There is no difference between the power of discipline that may be enforced over the members of an incorporated and unincorporated body. It all depends upon the form of the charter. There are incorporated clubs in all the States that have the power of discipline now enjoyed by the Exchange. Is it not more likely that the fear of incorporation is based upon the possible interference hereafter *by the State* with the limitation of membership or with the maintenance of the present enforced rate of commission? It cannot be based on Congressional action since Congress does not assume to deal with that question.

In connection with the much-discussed necessity of absolute and unreviewable control of the Exchange over the discipline of members it may however be said here parenthetically that the discipline maintained under freedom from governmental supervision has not been of such character as to constitute a very convincing argument in favor of the continuance of such despotic and unreviewable power. An examination of the record of punishments inflicted which will be found among the Exhibits accompanying the Report of the Pujo Committee furnishes forcible reasons in favor of the wisdom and necessity of judicial review. The offense most severely punished is the splitting of commissions or any infraction of the uniform commission rule. Fraudulent and fictitious transactions by which the public has been grossly swindled on an enormous scale and which have brought the Exchange into world-wide disrepute have been treated as mere venal offenses beside the crime of allowing a customer part of the commission.

Manipulation is considered legitimate provided commissions are paid at both ends of the manipulated transaction.

Notwithstanding these peculiar views of the duty of the Exchange to the public it urges the importance of its unrestricted control over the discipline of its members as the sole reason why it should not be forced to incorporate. Some would regard it as an added reason in favor of incorporation.

It is not apparent why such results in the way of the dis-

ruption of discipline as have been suggested by the Exchange should follow from giving an accused member whose reputation and entire business career and means of livelihood depend on the action of his co-members and competitors, the ordinary measure of justice of a right to review by an impartial authority. There is no danger that the Courts will deal less severely or less effectually than has the Exchange with the frauds practiced upon the public which it is the purpose of incorporation and regulation to prevent and punish. That would be difficult. Nor are they likely to regard manipulation with any less disfavor than the spokesmen of the Exchange, who have steadily insisted on attempting to defend and justify such practices by arguments that are surprising for their speciousness and lack of understanding of the public aspects of the business of the Exchange. These are however as before stated matters for the State to determine.

It is next suggested that if there is to be incorporation it should be left entirely to State authority and that the Federal government should not exact it or have anything to do with it. Yet when the former was attempted it was opposed with equal bitterness, apart from the fact that efforts at State legislation have proven a farce, as will be hereafter seen. There can be no efficient relief from that direction.

It would be manifestly unjust to have one set of conditions on which the New York Stock Exchange could use the mails and another or none for the Boston, Chicago, Denver or San Francisco Exchange. Uniformity of regulation is essential.

Boston and Chicago should no more than New York be permitted to prey upon the country because their respective States do not see fit to restrict them. That seems to me in and of itself a conclusive answer to the suggestion that each State should be left to determine whether the public market whose quotations are to have the use of the mails shall be subject to or free from supervision. The Federal Government is vitally interested in that question.

The two fundamental reasons in addition to a number of subsidiary ones, for requiring the incorporation of the Stock Exchange, may be recapitulated as follows:

1. To prevent, detect and punish the practice of frauds upon the public through manipulation, matched orders, wash

sales and like fictitious transactions, by means of which apparent values are created for securities in the world's markets.

This can only be accomplished through incorporation and the accompanying delegation to public authority of the right to examine *the books of members*, through which alone these transactions are discoverable.

The State and the Nation have each, separately and independently, the unquestioned right to safeguard the public against imposition on a subject that so nearly affects the interests of all its citizens. Neither is bound to permit an institution so pre-eminently public in its character and so vitally affecting the financial interests of the entire country and of other countries to remain uncontrolled. Such regulation involves no attempt to interfere with the individual in buying and selling securities except in a public market. Its purpose is to secure fair dealing in such a market. No one need become a member of such a corporation; but if as a condition of membership the law requires that his books shall be subject to inspection, none of his Constitutional rights are violated nor is it an interference with such rights to prohibit the individuals engaged in that calling from combining for the creation and operation of such a public market except through incorporation and under such regulations as the State or Nation may prescribe.

At the 1913 session of the Legislature of the State of New York, following the disclosures of the Pujo inquiry, a number of Bills, were passed that were supposed to be intended to meet some, but by no means all, of the existing evils. The extent of the power of the Exchange may be faintly gathered from the fact that never in its entire history and notwithstanding the scandals of all the past years in its management was there any attempt to legislate on the subject until the exposure of its methods brought the people face to face with the conditions that had been so long tolerated.

The Stock Exchange points to these belated Bills as demonstrating that incorporation is not now necessary in order to regulate the Exchange.

I consider none of them as of any value. Only the bills to which the Exchange consented were passed. None of them meets or even attempts to deal with the worst evils under the present system. A Bill to require incorporation was defeated, as it deserved to be. I opposed it as a mere "blind," as are

those that were passed. The only relatively important Bill passed is that which purports to prevent manipulation—but it does no such thing. It will serve only to legalize and perpetuate the existing abuse by *excluding* it from the definition which should include it.

The Bill reads as follows:

> *Manipulation of securities.* Any person who inflates, depresses, or causes fluctuation in, or attempts to inflate, depress or cause fluctuations in, or combines or conspires with any other person or persons to inflate, depress or cause fluctuations in, the market prices of the stocks, bonds or other evidences of debt of a corporation, company or association, or of an issue or any part of an issue of the stock, bonds or evidences of debt of a corporation, company or association, by means of pretended purchases and sales thereof, or by any other fictitious transactions or devices, for or on account of such person or of any other person, or for or on account of the persons so combining or conspiring, whereby, either in whole or in part, a *simultaneous change of ownership* of or interest in such stocks, bonds or evidences of debt, or of such issue or part of an issue thereof, *is not effected,* is guilty of a felony, punishable by a fine of not more than five thousand dollars or by imprisonment for not more than two years, or by both.
>
> A *pretended* purchase or sale of any such stocks, bonds or other evidences of debt *whereby,* in whole, or in part, *no simultaneous change of ownership or interest therein* is effected, shall be prima facie evidence of the violation of this section by the person or persons taking part in the transaction of such pretended purchase or sale.
>
> (*The italics are ours.*)

This Bill stands in the way of effective legislation to prevent manipulation and that is precisely what it was intended to do.

Manipulation of securities is not accomplished to any appreciable extent by *fictitious* transactions. As now practiced upon the Exchange it *does* result in a change of ownership, so that the most widespread forms of manipulation practiced on the Exchange are not reached by this Bill.

When a banker or a broker wants to create a fictitious *appearance* of activity in a given security for the purpose of stimulating dealings in it or to advance or depress the market price, he no longer does it through matched orders or washed sales. He gives at the same time to a number of different brokers orders day by day—and sometimes hour by hour—to sell the security on a scale either up or down, dependent on whether he wants to advance or depress the price; and

he gives at the same time and as part of the same operation to another set of brokers orders to sell on a scale. These brokers are not supposed to know—and often do not know—of the counter-orders that have been given. The effect of these transactions is, however, to create a nominal change of ownership accompanying every transaction and yet at the end of the day the operator has probably neither bought nor sold the stock on general balance although the records and quotations of the transactions as published and scattered throughout the country will show great apparent activity and heavy dealings and rising or falling prices when there have been in fact no dealings other than those of this operator on both sides of the market, except the purchases and sales of such victims and the gambling transactions of such "room traders" as have been attracted to the stock by this false appearance of activity.

The violent protest that was made before you of the definition of "manipulation" contained in subsection (a) of Section 5 of this Bill is easily understandable in the light of this explanation. Your especial attention is invited to that definition. Is there anything in it that would apply to an honest transaction? Or to which there would or could be objection if the members of the Exchange were not determined to cling to these illegitimate methods just as they clung to the disgraceful practice of permitting dealings in "blind pools" under the guise of their "Unlisted" Department until 1910?

This provision forbids only transactions that are made for the purpose of giving a *false* appearance of activity or of *artificially* influencing the market in order to buy or sell or to attract public attention so as to induce purchases and sales by others.

Why should there be such a storm of opposition to forbidding such practices?

No law will reach these transactions unless the Exchange is subjected to legislative control through incorporation, with the right to some public authority to examine the *books of its members*. The mere existence of such authority will *in and of itself* be a powerful deterrent. In view of the concession that at least one-third of all the transactions are those of members themselves for their own account and of the statistics showing that upwards of 80% are purely speculative there would appear to be urgent need of every deterrent that can be lawfully applied. If you want almost ocular demonstra-

tion of the processes and baneful results of manipulation to the extent of hundreds of millions of dollars within a few months look at the sheets and diagrams showing the trend, character and extent of the dealings in Amalgamated Copper Company during the period between December, 1906, and October, 1907, to which reference has elsewhere been made.

In those eleven months there were *over thirty-two million shares* dealt in of a Company that had only one and one half million shares. Stated in *dollars* the dealings in that eleven months in that one security amounted to over *three billion* dollars. Look also at the range of prices. On a single day (March 15th, 1907) there were 2,147,005 shares sold—which was one and one half times the entire capital. Or still more instructive, look at its record between June, 1901, and November, 1903, when the price went from $130 to $35 per share and again the capital was bought and sold many times over and over again each year.

An examination of the charts and statistics of other Companies, such as Reading and U. S. Steel, tell the same story. The same old game is repeated over and over again by "insiders" operating through pools and syndicates in the manipulation of vast blocks of securities, either forcing the prices up and unloading them on the public or forcing them down to shake out the public preparatory to another raid.

It is a notorious fact that James R. Keene, who managed the ill-fated Hocking pool, was employed to manage and that he in fact conducted pool operations in Amalgamated Copper and U. S. Steel stocks through market manipulations.

If the average human mind that has not been steeped in the intricacies of high finance can realize the magnitude of these transactions your attention is directed to that end to the figures showing the dealings in the securities of these two companies.

In 1906 and 1907 there were in all 1,400,000 shares of Reading Common stock listed. There were over *eighty-one million shares* sold in that time, starting at $164 per share and ending at $90. Those transactions represented *over eleven billion dollars* in money in sales and the same amount in purchases.

In U. S. Steel with 5,084,000 shares of common stock outstanding there were 74 million *shares* sold and the same num-

ber bought in 1909 and 1910. In a single month (January, 1910) there were over 6 million shares sold.

It will be said that this largely represents speculation. But is it *honest* speculation or speculative excitement brought about by pool manipulation? What part of it is pure manipulation?

Here again there have been selected by way of object-lesson only a few of the instances that might be multiplied but prominent cases have been taken to illustrate the point. Unless these practices are made discoverable and punishable there is no reason why they should not be repeated when conditions are again favorable.

Many of our great fortunes have been amassed by these methods. Who first knew when U. S. Steel common stock was to be put upon a dividend basis? Or when Union Pacific was to increase its dividend to 10%? Or when Amalgamated Copper would reduce or pass its dividend? Or when and on what basis it would resume dividends? The determination of these questions generally rests with one or at most a few men in each Company. It was natural that they should make use of their advance knowledge so long as there was no law or public sentiment to restrain them. But the temptation to force dividends and to suspend dividends and otherwise to use their vast power are too great. They must be removed if we are ever to have honest corporate management.

It may be that under the new order of things we shall not have the same class of men in our boards of Directors. That is probably true. The incentives will no longer be there. They were dishonest incentives but strange to say it was not considered dishonest for a Trustee to exploit his shareholders. It was considered rather clever even to the point of selling the stock of his own Company "short" and shaking out his shareholders.

It should be made impossible for the men who are in control of these vast enterprises to go on fleecing the public. It is high time that they were brought to realize that they are Trustees for their shareholders.

In no other country are such practices tolerated.

Subsection (i) of Section 1 of the Bill is intended to put a stop to the use by directors of inside information as a basis for speculation. There is no reason why a director should secretly trade in the securities of his Company nor

should it be possible further to use the mails to promote such exploitation.

As illustrating the insincerity of the proposed Bill requiring incorporation to which I have referred as having been defeated in the last New York Legislature, I call attention to the fact that the Bill empowered the Superintendent of Banks to examine the books of the *Exchange,* but *not the books of its members.* As the Exchange claims that it conducts no business and keeps no books, that was rather an empty formality. What is needed is the power to examine the books *of the members.* Without that power no law against manipulation is of the slightest avail.

The Governors of the Stock Exchange now have that power and exercise it summarily. Are public officials less entitled to be trusted? Few brokers would dare take the risk of conviction if their books were made subject to inspection. The law against railroad rebates would be a dead letter unless the Commission had power to examine the books of the railroad companies. The same is true as to the members of the Exchange to discover manipulation. Nothing short of that will ever do so. As matters now stand there is not the slightest peril in such transactions.

Another of the many abuses exposed by the inquiry of the Pujo Committee, which the Exchange claims has been corrected by the New York State legislation of 1913 is that of the hypothecation by brokers of the securities belonging to their customers for loans to the brokers in excess of the amount owing by the customer to the broker. As the result of this practice, whenever the broker became insolvent the customer lost his stock through its sale by the creditor of the broker. The customer may owe 50% of the value and the broker may have borrowed 80% or 90% of such value. The law of 1913 pretends to, but does not correct this flagrantly dishonest practice which the Exchange has permitted to go unchecked all these years.

In other States where there has been no attempt at legislation following these exposures the Stock Exchanges continue to tolerate this form of fraud without even the modification that has been introduced in the New York Exchange.

The New York broker now goes through the formality of requiring from his customer at the inception of their dealings

an omnibus consent applicable to all transactions to the use of his (the customer's) securities for an amount greater than is owing the broker by the customer. This has little less justification than the other. Why should the broker be permitted to exact the right to do business on the capital of his customers? Is it any wonder that one-third of all the transactions on the Exchange are for the broker's own account? One of the most effective means of checking the worst form of speculation is to prohibit this practice.

Still another remedy will be to require every purchase and sale to be delivered or "cleared" through the Stock Exchange Clearing House, as checks are now cleared in the various Clearing House Associations instead of permitting a mere delivery of balances as is now the rule in the Stock Exchange Clearing House. Still another remedy will be to require that at the time of purchase the broker be paid 20% of the then purchase price. It would not be necessary to keep good any such margin. Its requirement at the beginning would be a wholesome deterrent against the worst form of gambling—by those who can least afford it and who are always the surest victims.

The Exchange takes unto itself credit for the recent rule forbidding its members to accept the accounts of clerks of banks and trust companies but it does not extend the rule to the officers of those institutions. The defalcations from stock gambling by clerks are negligible compared with those of the officers of corporations.

Still another rule of the Exchange quite as reprehensible as any that were exposed and quite as repugnant to the sense of justice is that which assures to all the members of the Exchange a preference against the estate of a bankrupt member for all debts owing such member to the full extent of the value of the membership seat over the claims of the victimized customers of such bankrupt. It often happens in such cases that the "seat," which is worth from $40,000 to $100,000—dependent on the activity of speculation—is the only valuable asset of the bankrupt. Every dollar of that money is applied toward paying the creditor-members in full to the exclusion of the outside creditors. If the broker has re-hypothecated your securities for twice what you owe him and they have been swept away you get nothing except your share of what is left after the members of the Exchange have been fully paid.

Such a condition would not be permitted to survive incorporation and regulation.

This rule is defended as essential to the present system under which the members accept one anothers' obligations for large sums. The defense appears to me most inadequate. What becomes of the much-prized code of honor of which the members are so proud if it must be fortified by a preference over other creditors? There is a fine spirit of commercial honor among the members that is unique and that makes it possible for them to conduct large transactions in the heat of excitement by mere word of mouth with amazing smoothness and freedom from repudiation or controversy and which should render this injustice to their customers unnecessary. It should be made impossible.

To leave the disciplining of members for manipulation in the hands of the Stock Exchange Governors, without the right of judicial review would be like relegating to the Association of Railway Presidents the punishment of one another for granting rebates. Or to an Association of the Presidents of the Trusts the power to determine violations of the Anti-Trust Law and to inflict punishment. In what other department of the administration of justice is the punishment of crimes left with the colleagues of those who are charged with the commission of such crimes? Yet it is now seriously proposed that whilst the evidences of these crimes shall be available to the Governors of the Exchange (as it now is under its rules), so that they may inflict punishment, such evidence shall not be made available to the public authorities!

2. The second important result to be gained by incorporation will be to secure complete publicity of the profits of bankers, brokers and intermediaries in the flotation of Companies and the exposure of all the salaries, commissions and other profits of officers and Directors, through the control of the Department of the Exchange for the listing of securities, to enforce the listing of proper securities, and to prevent those that have once been listed from being stricken from the list without notice and the right of review.

Bonds of the City of New York were recently refused a listing because they were engraved by a company that was in litigation with the Exchange over the refusal to list securities engraved by that Company.

Listing on the New York Stock Exchange gives to a security a public market and a definite current value, rendering

it salable and available as collateral. Securities are not generally available as collateral for Stock-Exchange loans unless they are listed.

The Constitution of the New York Exchange provides that the Committee on Stock List

> shall have power to direct that any such securities or temporary receipts be taken from the list and further dealings therein prohibited;

and that the Governing Committee

> may suspend dealings in the securities of any corporation previously admitted to quotation upon the Exchange, or it may summarily remove any securities from the list.

A regulation dated March 27th, 1895, further provides that

> Whenever it shall appear to the Committee on Stock List that the outstanding amount of any security upon the Stock Exchange has become so reduced as to make inadvisable further dealings therein upon the Exchange, the said Committee may direct that such security shall be taken from the list and further dealings therein prohibited.

Acting under this authority, the Governing Committee and the Committee on Stock List have frequently removed securities from the list. Stocks have been so removed on the ground of an insufficient amount outstanding, simply because a large proportion of the issue has been absorbed by some other corporation.

Taking a security from the list is a serious injury to the holders by depriving them in large part of a market and making borrowing upon such security difficult if not impossible.

Obviously, therefore, the effect of prohibiting further dealings in the stock of a corporation when the great bulk of it has been acquired by one person, group or corporation is, whether intentionally or not, to coerce small stockholders into selling out to the majority holders. It destroys their market.

Striking illustrations of the operation of this regulation are not lacking. Thus, on the reorganization of the Southern Railway Company by J. P. Morgan & Company a majority of its stock was placed in a Voting Trust, which deprived the stockholders of all representation and voting powers and vested the absolute control of the Company in the Trustees—J. P. Morgan, George F. Baker and Charles Lanier, who, upon the transfer of the stock into their names, issued the usual Trust

Certificates, which were listed and traded in on the Exchange instead of the stock certificates. When this Voting Trust expired in September, 1902, the Trustees, through J. P. Morgan & Co., requested certificate-holders to extend the Trust. New Trust Certificates were issued to those assenting to the extension and these were listed on the Exchange. In March, 1903, the old Trust Certificates were removed from the list, although there were at that time, which was six months after Messrs. Morgan had requested the extension of the Voting Trust, certificates representing 183,938 shares whose holders were apparently unwilling to further resign their voting powers. The result was that those not assenting to the extension of the Trust, and hence not taking new Trust Certificates, found themselves with a security not listed on the Exchange, and therefore without a ready market and not available as collateral. The listing of the extended Certificates and the removal from the list of the old ones, whether so intended or not, operated as a means of coercing the holders of these 183,938 shares into exchanging their old certificates, in order to get a listed security which could be sold or made available for borrowing purposes. It is now nineteen years since that Voting Trust was created, and it has not yet been dissolved.

Again, in the development of the Tobacco Trust, a few men who were in control of the management organized a new Company known as the Consolidated Tobacco Company, to the stock of which they alone were permitted to subscribe. The then outstanding stocks of the American Tobacco Co. and the Continental Tobacco Co. were earning such large dividends and the prospects were so alluring that the insiders conceived the scheme of taking the equities in these companies unto themselves by the organization of this new Company which was to acquire the outstanding stocks by issuing in payment for them 4% bonds of the new company charged upon the stocks thus acquired at the rate of 200 in bonds for each $100. share of American Co. stock and par for par for each Continental Co. share. The insiders thus acquired the vast equities in these companies without paying any cash except that they nominally paid in 25 per cent. of the $30,000,000 capital (which they shortly thereafter repaid themselves in the form of a dividend). The bonds had no security behind them other than the stock that was being re-

ceived in exchange, and the subscriptions to the stock of the Consolidated Company.

It was one of the most remarkable *coups* ever consummated in the world of high finance and is said to have netted many millions to the inventors of the scheme but at the expense of the shareholders. The exchange of the old stocks for the new bonds having proceeded until the Consolidated Company had acquired all but 11,357 shares of the common stock of the old American Tobacco Company, the Tobacco stock was removed from the list and in its place the new convertible bonds of the Consolidated Co. were listed without notice to the holders of the outstanding 11,357 shares of the Tobacco Co.

It is admitted by the Governors of the Exchange that the effect of this action might be to further the schemes of the promoters of this enterprise to take from the stockholders their equity and transfer that equity into the pockets of the promoters. When that stock was stricken from the list it ceased to be readily available as collateral, as it had lost its market quotation. Its best market thereafter was manifestly among the insiders, who understood its intrinsic value.

One of the most striking instances of the oppression of minority stockholders from the operation of this rule came to light through the questions put by a member of the Committee. It was in connection with the striking from the list of the stock of the Kanawha & Michigan Railway Company of Ohio, which occurred in 1910 but which I had erroneously placed from memory as having occurred some years earlier. Although concerned in the transaction the details had entirely escaped my recollection.

It appears that the road had at one time been a prosperous, independent property but had, contrary to the Anti-Trust Law, come under the control of the Hocking Valley, which was a parallel and competing line, where it remained for many years. This control was represented by a bare majority of less than 51% or $4,510,000 of the then outstanding capital of $9,000,000.

During all the years that it was under such control it eked out a precarious existence, whilst the controlling road developed great prosperity and earned large dividends at its expense. The stock had been selling around $40. per share. The minority began agitating for a change in this intolerable condition and in 1909 the Hocking interests, under

pressure from the minority, made an offer of $72. per share for the outstanding stock. What amount, if any, had been meantime acquired by the controlling interests in the market at lower prices does not appear.

Most of the minority holders, worn out by the delays and disappointments of years and unwilling to incur the expense and uncertainty of litigation to protect their rights, accepted the offer.

Others, controlling about 3300 (not 6800 as I supposed) shares, some of whom had owned the stock for 15 or 20 years and whom it had cost with interest between $200 and $300 per share, refused to be driven into accepting the Hocking terms. A Protective Committee was formed and suits were begun in the Ohio Courts to compel the Hocking to release its illegal and destructive grip on the road and to account to the Comapny for the lossess sustained during the many years of control by the Hocking.

Whilst this litigation was pending the stock, which had been for 20 years a listed security, was stricken from the list, without notice or warning, under the statement, as afterwards appeared, that there were in all only 2,000 or 2,200 shares outstanding.

The undoubted purpose of that action was to discourage the litigants by destroying the market for their stock and rendering it unavailable as collateral.

After costly litigation the stock represented by the Committee was sold to the controlling interests at $165. per share. With an operating mileage of over 187. miles in the heart of one of the richest parts of the country, an exceptionally strategic position, a bonded debt of only $4,969,000 or at the rate of less than $30,000 per mile, a capital of only $9,000,000 or at the rate of only $50,000 per mile, and admitted earnings as shown below, the price paid does not by any means represent the intrinsic value of the stock, but the prospects of endless lawsuits against these powerful interests, with the endless delays and enormous expenditures involved, were not alluring.

Fortunately the Government almost immediately took up the fight and the control was changed.

Now mark what happened: I quote from Moody's Manual of Railroads and Corporation Securities, which is recognized as the standard work on railroads, for 1914, (pp. 600-602):

> The Lake Shore & Michigan Southern Ry. and the Chesapeake & Ohio Ry. Companies early in 1910 acquired $4,510,000 of this company's stock and up to June 30, 1913, had purchased 35,484 additional shares from the minority stockholders, making a total of $8,058,400 of the stock held by the Lake Shore and Chesapeake & Ohio companies, as of that date.
>
> (p. 600.)

According to this statement there are still 9,416 shares outstanding. And yet the stock was stricken from the list on the unsupported assertion that there were then only 2,000 or 2,200 shares outstanding.

Note further what happened to the stock that had not paid a dividend during all the years of the Hocking control, after this $3,548,400 of minority stock was sequeezed out of the hands of its owners at the price the majority interests chose to put upon it (Moody's Manual p. 600):

> *Dividends.*—Initial dividend of 4% paid June 30, 1911; 2½% each paid Dec. 30, 1911, June 30, 1912 and Dec. 30, 1912; 2½% and 1% extra June 30, 1913; Sept. 30, 1913, 1¼%; Dec. 29, 1913, 1¼%. Dividends payable quarterly M. J. S. D. 30 at J. P. Morgan & Co., New York.
>
> (p. 600.)

> For the fiscal year ended June 30, 1913, the total net income *available* for dividends on the stock, after payment of all fixed charges, amounted to about $5,172 per mile and the present dividend of $5.00 per share on the stock requires $2,556 per mile. Therefore about $11.16 per share was earned with which to pay the 5% dividends on the stock.
>
> (p. 602.)

Moody's report also contains this statement:

> The increase in train load tons tells the story and it is my opinion that earnings are being concealed and that some day will suddenly become evident.
>
> (p. 603.)

It will be observed that almost immediately after the Hocking took its grip off the property and after the insiders had bought out the minority interest of over 48%, the road began to show large earnings and is now showing over 11% per year, besides the concealed earnings referred to in Moody's.

In Moody's of 1911, its financial railroad expert includes the following statement in his report of May 8th, 1911:

> The marked change in net earnings for 1910 compared with the previous year is a very good illustration of how the earnings of such controlled roads are subject to manipu-

> lation by the arbitrary diverting of traffic to or from the property. This is one reason why I do not recommend the purchase of minority stocks, although the possibility of profit is sometimes great.

In the face of this state of facts it was intimated by the questions put at the hearing that in selling the stock represented by them at $165. per share the Protective Committee had practically "held up" the confiding and unprotected majority interests in the Kanawha, knowing that the latter was required by some law or rule or for some purpose, that was not stated or suggested, to acquire all the outstanding stock. That there was no basis for this assumption is evident (1) from the fact that the Protective Committee did not control all the outstanding stock and that there are 9,416 shares of it apparently still outstanding and (2) that the Protective Committee's charges of oppression on the part of the majority are amply justified by the present disclosed earnings of over 11% besides the supposedly concealed earnings. In view of these disclosures it would be interesting to know where in the judgment of your Committee the "hold up" occurred. Was it on the part of the minority stockholders who had been kept out of the fruits of their investment and who finally accepted a fraction of the value of their stock? Or was it on the part of the insiders who forced and kept down the value of the stock and had it stricken from the list until they succeeded in "gathering in" over 80% of the outstanding minority interest on their own terms?

The holders of this stock, as did the holders of Southern Railway securities and of a number of others that have been stricken from the list, presumably made their purchases while the securities were listed. They did nothing to forfeit their right to have them remain on the list and thereby keep the market they had when they acquired their holdings. Yet without reason or notice the holders find themselves confronted with the alternative of selling at a price fixed by the purchaser or having their market destroyed.

The rule authorizing the removal of a stock from the list is defended on the ground that where all but a small proportion of an issue is held in a single control it is easier to manipulate the price of it and create a corner in it. This contention when analyzed amounts to the assertion that an investor who bought his stock relying upon its being a listed security must be penalized in order to protect a speculator

who may sell stock that he does not own and is unable to buy it to make delivery. No one who owns what he is selling is in danger of a "corner."

Why should not the Stock Exchange be prevented from lending itself to such schemes? Why should there not be supervision and the right of review of these public functions of listing stocks and removing them from the list? What argument can be advanced for permitting this autocratic, irresponsible and unreviewable power, so long abused and made the creature and football of high finance, to continue? Judicial review can never work injustice. If the action is supported by reason or by so much as a decent pretext it will be sustained. If not it should be and will be overruled.

There is much more that can and should be said in favor of the necessity of this Bill as a reformatory and constructive measure but I have already trespassed too long upon your patience. I again ask you in conclusion to study the Report of the Pujo Committee on this subject and the diagrams and statistics on which it is based if you want fully to realize something of the extent to which the masters of high finance have preyed upon the people through the machinery of the Stock Exchange and how the rules of the game have been so framed and the delicate mechanism so adjusted as to play, often unconsciously, into their hands.

Through the incorporation of the Stock Exchange there is offered an opportunity to end this carnival of exploitation. The Exchange should be made the most powerful weapon for enforced publicity of corporate affairs and its business should be augmented many times over whilst at the same time it would be performing the highest order of public service.

The fact that this incongruous form of irresponsible government of the greatest of our national agencies of finance has been tolerated all these years furnishes no reason why it should longer continue. It demonstrates the dangerous power that the financial interests have wielded over governmental agencies. We have not yet begun to understand the potency of this unrestrained power and have therefore been content to be led by specious arguments to leave undone some of the most important functions of government. It is

high time that we direct our attention to this and like important branches of regulation.

Pray do not misunderstand me. I have not intended in anything I have said to reflect upon the integrity of the membership of the New York Stock Exchange, taken in its entirety.

Judged by the standards of the past I venture to assert that there is no body of men in the country with a greater respect for their obligations. But happily our standards are improving. Methods that were considered legitimate ten years ago and that are still practiced in many quarters of the financial world are now seen to be intolerable. Others, such as the dealings of officers and directors with their corporations that are still permitted, will soon be defined as crimes, as they are in other countries. It will not, for instance, be long before bank officers and directors will be prohibited from exploiting their banks and other corporate officers will be prevented from withholding information and speculating on advance knowledge.

In judging, however, the point of view of the members of the Exchange we must remember how difficult it is for one to adjust his perspective to changed conditions and public sentiment that conflict with self-interest and long continued license. All of our judgments are apt to be warped where self-interest obstructs our vision. But the strange part of it all is that these gentlemen are not only blind to the possibility of infirmity in their judgments as to the necessity for Governmental control, but are not even willing to accord to the critics of their methods the common justice of good faith and honest public-spirited motives in maintaining a different point of view. They simply cannot understand that point of view.

I am convinced that the time will come, and before long, after incorporation and regulation have been enforced when those who are now bitterly assailing the champions of this legislation in the vain hope of thereby diverting the issue will find that it has marked the dawn of a new era of usefulness and prosperity for them and the Exchange and will feel grateful to those who have pointed the way.

Respectfully submitted,

Samuel Untermyer,
in support of Bill.